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A Global History of Accounting, Financial
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Previts,
Walton,
Wolnizer
Editors



A GLOBAL HISTORY OF ACCOUNTING, FINANCIAL REPORTING AND PUBLIC POLICY

Eurasia, the Middle East and Africa

Edited by
Gary Previts, Peter Walton
and Peter Wolnizer

Studies in the
Development of
Accounting Thought
Volume 14D



THE UNIVERSITY OF
SYDNEY
THE ACCOUNTING
FOUNDATION

A GLOBAL HISTORY OF
ACCOUNTING, FINANCIAL
REPORTING AND PUBLIC POLICY:
EURASIA, THE MIDDLE EAST AND
AFRICA

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THOUGHT VOLUME 14D

**A GLOBAL HISTORY
OF ACCOUNTING,
FINANCIAL REPORTING AND
PUBLIC POLICY: EURASIA, THE
MIDDLE EAST AND AFRICA**

EDITED BY

GARY PREVITS

ESSEC Business School, Paris, France

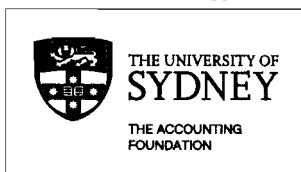
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FOREWORD

In August 2009 Professors Peter Walton, Peter Wolnizer, and I met during the annual meeting of the American Accounting Association to plan to produce a set of volumes which would address the global development of accounting, financial reporting, and public policy in several key sovereign states.

This volume represents the fourth and final contribution to that set. Altogether 28 nations are studied in these volumes. The first three volumes considered nations of Europe, the Americas, and then Asia and Oceania. This fourth volume addresses nations in Eurasia, the Middle East and Africa.

All of the volumes have been patterned after the 1995 work of Professor Walton entitled *European Financial Reporting: A History*.

As Editor of this volume, and of the second volume in the series, I am pleased to present it for your consideration. As volume editors, Professors Walton, Wolnizer, and I also wish to acknowledge the professional editorial work of Mr. Richard Casna and Mr. Eritt Sinkko who has assisted us in the preparation of materials and the contributions of my retired colleague, Professor Robert J. Bricker, for his development of an excellent index. He is my coeditor in the parent Emerald Series, *Studies in the Development of Accounting Thought*, and has demonstrated a skill for indexing which adds value to these volumes and improves their reference worth.

We acknowledge our appreciation as well to all of our chapter authors, the editors at Emerald and to the Accounting Foundation of the University of Sydney in particular for financial support.

Our goal in developing these volumes has been to provide historical sourcebooks which, while not timeless, will have a durable usefulness as a reference for professionals, professors, regulators, and students from our discipline and other fields who seek to improve their understanding of the origins and development of accounting, financial reporting, and public policy in key economies of the world in the early 21st century.

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CHAPTER 1

EGYPT

Salah A. Mostafa Ali

INTRODUCTION

The main objective of this study is to introduce a historical review of the evolution of accounting practice and thought in Egypt. This will help us to understand, evaluate, and develop the current accounting picture.

Egypt is one of the Middle-Eastern and African countries. It has an ancient heritage of culture and civilization and has played an essential role in Arab regions and the continent of Africa. The Egyptian Exchange (EGX) reached its historical peak in the 1940s when it constituted the fifth largest market in the world. After several decades of low market activity as a result of socialism, the exchanges started growing again in the early 1990s, spurred by economic reform, privatization, and changes in the regulatory environment (The World Bank, 2004). These characteristics give this study a special importance.

Egypt has a vast and rich history dating back 7,000 ago. It begins from the Pharaoh era followed by the Greek Empire, Roman Empire, Islamic Civilization, French and British Occupation, to the modern Republic as it is today. As mentioned above, the historical evolution of accounting in Egypt can be divided into two main phases: ancient accounting and modern accounting (Farag, 2009; Nammar, 1981).

Ancient accounting can be approximately dated from 4000 B.C. to 1883 A.D., when Egypt adopted the Commerce Act. During that period, the

accounting practice was affected by prospective political, cultural, and economic developments. In early times, the use of papyrus rather than clay tablets allowed more extensive records to be employed and checked by an elaborate internal verification system, particularly for the network of royal storehouses within which the "in kind" tax payments were kept.

During the ancient accounting period the ideas of bookkeeping, the accountability, governmental accounting, tax accounting, and internal auditing and control systems were initiated. On the other hand, during the modern accounting period, several political and economic changes affected accounting practice and thought, and the most recent development in accounting took place in 1966, when Egypt adopted the standardization of the accounting system.

This study seeks to contribute to the literature on accounting history in certain ways. First, the chapter adds to the scant literature on accounting history in both ancient and modern eras, particularly in Egypt. Second, the study encompasses the evolution of accounting as a profession and as a thought.

In addition to the Introduction, this study contains three main sections. The first section contains the ancient accounting, which is divided into three stages. The second section covers the modern accounting, which is divided into six stages. The final section includes the main conclusions.

ANCIENT ACCOUNTING (4000 B.C.–1883 A.D.)

During the ancient accounting period, several civilizations and empires controlled Egypt. The Pharaoh era lasted from 3300 B.C. to 332 B.C., when the Greek empire led Egypt until 30 B.C., then the Roman Empire continued in power until 639 A.D. The Islamic revolution came about in 639 A.D., and then Egypt was governed by French and British occupations from 1798 until 1952, when the country declared its independency.

The Pharaoh Era (3300 B.C.–332 B.C.)

The Pharaoh era has been divided by scholars into five phases (Ezzamel 1997; Grimal, 1992; Kemp, 1989): the early dynastic period (from 3300 B.C. to 2700 B.C.); the Old Kingdom (from 2700 B.C. to 2200 B.C.); the Middle Kingdom (from 2050 B.C. to 1780 B.C.); the New Kingdom (from 1552 B.C. to 1080 B.C.); and the late dynastic period (from 1080 B.C. to 332 B.C.).

The most important political event that affected the economic activities and the accounting practice during that period was the unification of Egypt into a central state. The state played a major role in the life of the people, the economy, the military, and the administration.

The economic activities undertaken in that period belonged mostly to the state and little to the private sector. The state economic activities were related to institutions and temples, which were engaged in large business, such as buildings, workshops for tools, and manufactories of metals. Also, agriculture was one of the most important economic factors, which provides food and raw materials for both the public and business. Practicing economic activities required substantial organization, allocations of tasks and duties, and monitoring of achievements (Quirke, 1990). Therefore, a new job was created, the scribe, who was similar to a clerk or journalist and was responsible mainly for bookkeeping.

Despite the fact that the money system was not yet invented, the ideas of bookkeeping, tax, and accounting were accomplished. A tax was assessed and levied against crops and then collected, recorded, and stored by scribes, which formed a significant part of the state revenues. Ezzamel (2002a) sheds light on the taxation issue by examining more documents related to the New Kingdom; these documents trace the "cycle of taxation" which involves the definition of taxable entities, final assessment, collection, transportation and storage of taxes, and more. Further evidence examined by Ezzamel (2002b) from the Middle Kingdom period about the summary of accounts of a royal visit included in papyri: (i) statements of accounts; (ii) orders of provision earmarked for specific individuals; (iii) expenditure of valuable commodities as lists of offerings; and (iv) official reports and documents.

The functioning of accounting in control and accountability was documented by Ezzamel (1997). Accounting was used to monitor the conversion of inputs into outputs with specific reference to the functioning of a bakery. This was reflected in two distinct, yet related, phases: the development of input-output matrices and the keeping of regular and systematic accounting records to monitor the conversion of inputs into outputs and to trace the flow of bread (whether semiprocessed or as a finished product) through the bakery. The evidence provides interesting insights that have importance beyond the case of the bakery. It demonstrates that accounting systems in the New Kingdom had the capability to operate as powerful mechanisms for closely monitoring human performance in state institutions, and also as a means of endowing action with legitimacy by emphasizing conformity to expectations.

The Greek and Roman Empires (332 B.C.–639 A.D.)

The Greeks conquered Egypt in 332 B.C. and Egypt remained part of the Greek Empire until 30 B.C., when it became a part of the Roman Empire. Perhaps the most important Greek contribution to accountancy was its introduction of coined money around 600 B.C., and the widespread use of coinage took time, as did its impact on the evolution of accounting. Banking in ancient Greece appears to have been more developed than in prior societies. Among Roman accounting innovations was the use of an annual budget, which attempted to coordinate the Empire's diverse financial enterprises, limit expenditures to the amount of estimated revenues, and levy taxes (Alexander, 2002). Government accounting and taxation were practiced in late Ptolemaic and Roman Egypt. Examples include records for state granaries or for other crops, and detail government revenue from the collection of fish. Numerous registers list both eligible taxpayers and taxpaying villages. Taxes were paid for grain and produce, as well as for revenues gained by the sale of wine, beer, and oil.

Also, both the Greek and Roman Empires had superior accounting practice; they did not transfer to Egypt. They only used accounting as a tool to obtain more tax as source for the empires' expenditures. Egypt served as a major producer of grain for both the Greek and Roman Empires, and its wealth was harnessed for the imperial wars (Farg, 2009).

The Islamic Civilization in Egypt (639 A.D.–1798 A.D.)

In 639 A.D., the Roman Empire ended in Egypt and, after two years, the whole of Egypt was incorporated within the expanding Moslem Arab Empire. Following that was a chain of invasions from other Muslim divisions. It included the *Fatimiyeen*, the *Ayyubiyeen*, the *Mamluks*, and later the *Othmaniyeen*, until the 1978 French occupation.

The Islamic civilizations established some accounting principles, assumptions, and concepts, for example the idea of bookkeeping and recording the debt came from God in the *Qur'an*: "Oh you who believe! When you deal with each other, in transaction involving future obligations in a fixed period of time reduce them in writing. Let a scribe write down faithfully as between parties." One of the early institutions to regulate the market and prevent fraud was *al-Hisba*, which was established in the 7th and 8th centuries, that included all funds to be redistributed for the society. Also, an accountant

(*Muhtasib*) was appointed to ensure justice in society by means of the transactions on the market and traders' behavior (Gambling & Karim, 1991). The full disclosure and social accountability in order to satisfy any reasonable informational demand in accordance with Islamic rules was valued (Lewis, 2001). Islamic rules avoid *riba* (interest on credit) and use the equity structure of an entity and its influence on this entity's disclosure practices. Zaid (2001) addresses the topic of a double-entry system and underlines the possibility that Muslim traders developed and "lent" it to their Italian counterparts.

The effects of Islamic civilization in the history of accounting in Egypt are obvious. The development of Islamic financial institutions has contributed significantly to the emergence of a modern literature on Islamic accounting.

MODERN ACCOUNTING (1883–PRESENT)

Modern accounting can be dated from 1883 until now, and this period comprises six stages: (i) bookkeeping (1883–1914); (ii) recognition of the accounting profession (1914–1938); (iii) the growth of accounting as profession and science (1939–1952); (iv) the initiation of national accounting (1952–1961); (v) the republic economy and accounting standardization (1952–1974); and (vi) the transformation to market economy and the adoption of IAS (1975–present). Each of these stages reflects the impact of the socioeconomic conditions prevailing at the time.

The Bookkeeping Stage (1883–1914)

During this period, Egypt was an Ottoman province occupied by the British, following the French occupation, so most of the businesses were owned by foreign investors who had the benefit of no taxation in Egypt. In November 1883, the Commerce Act was issued, which required each business to hold three records, including the general journal, the inventory record, and the correspondence record. This act did not require any official qualifications and did not impose any fees in case of noncompliance. The act tried to organize the accounting records, especially with the diversity of Italian, French, and British accounting systems applied to businesses in that period.

The accounting goal in this stage focused on bookkeeping as a tool of evidence to be provided in case of litigation.

Recognition of Accounting Profession (1914–1938)

One of the most significant consequences of the 1919 revolution was the growth of the Egyptian national feeling, which resulted in establishing the Bank of Misr and the Egyptian Agricultural Bank, and increased the number of the Egyptian organizations, especially corporations. These developments in the Egyptian economy affected the accounting profession and created more need for accounting. In that period, for the first time, the Egyptian courts officially recognized accountants as professionals, and the government issued an important regulation concerning accounting disclosure in the corporations. The regulation induces any corporation to disclose in its annual report an income statement, balance sheet, board of directors report, and an auditor report. This disclosure reflects the importance of accounting information and its role for internal and external uses.

The accounting goal during this stage dramatically changed from book-keeping to providing the useful information, and accounting being recognized as a profession.

The Growth of Accounting as Profession and Thought (1939–1952)

Political, governmental, and economic corruption were characteristic of this period, which resulted from the British occupation. Keeping the populous uneducated was a main objective of the British occupation to justify its continuous suppression of Egyptian industry in favor of lop-sided agricultural development needed for British industries (Farag, 2009).

Because of the corruption that affected political, social, and economic life, the Egyptian government issued certain regulations which improved the economic situation and led to some growth in the accounting profession. One of the most important regulations was the Income Tax Act (Act 14 for 1939), which required all firms to submit financial statements supporting income tax returns to avoid ad hoc assessments. The Income Tax Act created some demand for accounting and auditing services; however, the number of qualified accountants was small, which shed light on the need for more accounting studies.

The continuous corruption in governmental organizations was a good justification for issuing the Governmental Accounting Act (Act 52 for 1942), which gave more attention to the accounting profession and its role to exercise control over the governmental organizations. Moreover, in 1946, the Egyptian Royal Society for Accountants and Auditors was formed, and it was the first organization for professional accountants in Egypt. The

membership in this organization required a candidate to pass comprehensive exams in accounting and auditing. One vital goal of that organization was the development of accounting as a profession and science. Also, in 1951, Egypt issued the first act to organize accounting and auditing practices (Act 133 for 1951). This act created three schedules: A, B, and C, and set the rule for registering in these schedules. In addition, a committee was formed by Ministry of Finance to review applications and grant licenses to practice accounting and auditing. The act did not require a qualifying examination for entry, and provided a broad framework for bookkeeping and financial reporting, but authorized the Ministry of Finance to develop a standardized chart of accounts and detailed instructions on the accounting treatments and reporting formats. The legal approach, which was taken in the early 1950s to establish a uniform accounting system, constrained the development and application of accounting standards that were conducive to high-quality financial reporting in a market economy. While this period was short, accounting as a profession and as a thought grew and developed considerably. Three factors led to this development: the issuance of several legislations; an increase in the number and size of corporations; and the formation of the Egyptian Royal Society for Accountants and Auditors.

Initiation of National Accounting (1952–1961)

The Revolution of 1952 and the Suez War in 1956 resulted in vital political, social, and economic changes in Egypt. The most important changes included the establishment of a republican system instead of the royal one and the adoption of a state socialism economy. Some economic regulations, such as the nationalization of banks, insurance companies, and most manufacturing companies, which created a large public sector, reached about 348 enterprises in 1961 (Farag, 2009). The Egyptian government controlled most of the economic activities.

This new situation affected accounting, and new goals and fields were initiated. Accounting gave more attention to the macro rather than the micro level, and the concept of national accounting appeared. Also, planning and control, as expanded goals of accounting, created more need for cost and managerial accounting. Under national accounting, public enterprises were evaluated on the basis of their ability to meet strategic needs, such as reducing imports, providing employment, meeting production targets, and promoting regional development. Profits, returns on investment, efficiency, and cost competitiveness became matters of secondary concern (Farag, 2009).

Another major achievement in the development of the accounting profession during that period was the issuance of the Syndicate for Accountants and Auditors in 1955. In 1958, the syndicate issued the code of professional conduct and ethics for practicing accountants and auditors.

Accounting for National Planning (1961–1973)

During this period, Egypt shifted from a capitalist to a socialist or centrally planned economy (Carana, 2002; HassabElnaby & Mosebach, 2005; Hassan, 2008). The Egyptian government set a broad national plan which required accounting information for all public-sector organizations. The accounting systems available at that time were not able to provide the nationalist planners with the information needed. The need for a standardized accounting system was recognized, and the government issued Act 4723 in 1966 (The Central Accounting Organization, 1966) to establish the standardized accounting system to be implemented in all public-sector organizations, except financial institutions, for the financial years 1967/1978. The main goals of that system were (Briston & El-Ashker, 1984):

- Provide the nationalist planners with all information needed for planning and control.
- The linkage between the entity financial reports and the national financial reports.
- Facilitate the collection, sorting, recording, and reporting of accounting data.

The standardized accounting system unified the following items for all public-sector companies (Hafz, 1972):

- Accounting terms, definitions, rules, and principles.
- Accounts and the statements.
- Schedules of accounting data.
- The fiscal year or the accounting period.
- The chart of accounts.
- The budget.

Moreover, the system required each economic unit to prepare the following reports at the end of each accounting period:

- Production and trading account.
- Current operations account.
- Profit and loss account.

- The sources and uses statements.
- The balance sheet.
- Cash flow account.

The reports produced by this system were useful for both the nationalist planners and the management of economic entities, especially in planning and control decisions. The standardized accounting system expanded to include cost accounting in addition to financial accounting, which provided more information to benefit decision-makers at the entity, sector, and national levels.

The Central Auditing Organization became the governmental agency responsible for auditing the public sector, including state-owned companies, in addition to all governmental bodies and authorities. So, the role of audit firms and individual auditors was significantly scaled down, and, consequently, the audit market substantially shrunk. One might say that this period was the most horrible time for the auditing profession in Egypt.

Transformation to Market Economy and Adoption of International Accounting Standards (1974–Present)

After the 1973 war, between Israel, Syria and Egypt, Egypt adopted new strategy to liberate the economy and transformed to a market-based economy. This economic transition toward a more capitalist orientation affected the country's cultural and socioeconomic environment (Dey, Grinyer, Sinclair, & El-Habashy, 2008). Several laws were issued to attract both Arab and foreign investments, and a special governmental body, the General Authority for Investment and Free Zones, was founded to supervise foreign investment. In 1974, the government issued law 43 for 1974 regarding the Arab and Foreign Capital Investment and Free Zones. The law sought to provide incentives to investors in many sectors, including industry, land reclamation, tourism, and banking. It offered concessions on imports, profit transfers, and taxation, as well as guarantees against nationalization. In 1977, this law was amended by law 32 and was later replaced by law 230 in 1989.

In 1981, The Company Law 159 for 1981 required all companies to prepare and disclose annual audited financial reports and maintain sound accounting records. Moreover, according to this law, the annual general meeting of shareholders should monitor the auditor performance and appoint a new auditor or renew the appointment of the existing auditor.

Concerning financial institutions, the Central Bank of Egypt monitors performance of auditors and reviews auditors' reports and corporate annual reports prior to their presentation at the shareholders' general meeting. The Company Law 159 of 1981 also requires auditors to report the following at the annual general meeting: (i) that all data and explanations for satisfactory fulfillment of duties have been obtained; (ii) that the company maintains satisfactory accounting records; (iii) that all relevant legal requirements have been reflected in the accounts; (iv) that the financial statements provide a true and fair view of the company's financial condition and results of operations; and (v) that the inventory has been recorded in conformity with applicable rules. The Company Law does not cover accounting and auditing standards but requires that external audits should be conducted in compliance with the Accounting Practice Law 133 for 1951. According to provisions of the Company Law, the auditor or any relative of the auditor must not be a founder, director, permanent consultant, or employee of the clients. However, there is no restriction on shareholders being appointed as external auditor of the company.

The Public Business Sector Law 203 was issued in 1991 to restructure all public-sector companies and set the initial step for privatization. The ownership and management of 314 public-sector companies were transferred from the various ministries to 17 holding companies. Under this law, foreign investors are free to participate in the securities market without any ownership-related restrictions. The same administrative and legislative rules apply to both Egyptian companies and international financial organizations. The transition posed challenges for the government, private-sector institutions, and the accounting profession. The aim was to increase the role of the private sector. There was, therefore, a need for changes to and reforms of accounting systems to improve decision-making to attract investment, stimulate economic development through increased competition, and enhance the level of confidence of foreign portfolio investors in the Egyptian capital market.

In 1992, the government issued the Capital Market Law 95 (Capital Market Law, 1992), which required all listed companies to prepare financial statements in compliance with the IAS. This Law mandated all listed companies to file annual and semiannual audited financial statements and quarterly financial statements with the Capital Market Authority and the Cairo and Alexandria Stock Exchange. The quarterly financial statements require limited review by auditors. The Capital Market Law also requires listed companies to publish financial statements in two widely circulated newspapers.

In order to have its own standards and be harmonized with the international community, the government issued Ministerial Decision No. 503, in 1997 (Investment Law, 1997), which established the Permanent Committee for Accounting and Auditing Standards to issue Egyptian Accounting Standards (EAS) that were to be based on IAS but adapted for local conditions.

From 1998, all listed companies in Egypt were required to comply with the new EAS. By 2000, there were 22 EAS, most of which are comparable to the corresponding IAS with the exception of minor differences. The main aims of the approach taken were to enhance the quality of information issued by listed companies, improve decision-making, attract investors, stimulate economic development through increased competition, and to enhance the level of foreign portfolio investors' confidence in the Egyptian capital market.

The Income Tax Act No. 91 for 2005 requires that net profits for tax purposes are based on the accounting profit in the audited financial statements that are prepared according to EAS, after adjustments by the tax inspectors, with some tax rules also being used for financial reporting purposes.

In 2006, the government issued Decree No. 243 by the Minister of Investment (Ministry of Investment, 2006) that replaced the old standards issued under the two ministerial decrees Nos. 503 for 1997 and 345 for 2002 by the new 35 EAS. These standards are applicable to all listed joint-stock companies. The new EAS were issued to comply with economic changes and scientific and technological developments either on the business performance level of the companies or on the level of the accounting systems to which they apply. The issuance of these standards is an important step in improving the application of principles of good corporate governance by listed companies.

The new EAS were prepared on the basis of IFRS (2005 version), except for some departures and adaptations. Preparers of financial reports refer to IFRS in cases where EAS does not address specific issues. The main departures and adaptations from IAS/IFRS are (The United Nations, 2010):

- (a) EAS 1 "Presentation of financial statements" (corresponding to IAS 1):
 - (i) Profit distribution to employees and members of the Board of Directors (employee benefits) are not recorded as expenses in the income statement, rather they are recorded as dividends distribution in accordance with the requirements of local law;
 - (ii) This departure also affects two other standards, namely EAS 22 "Earnings per share" and EAS 38 "Employee benefits";
- (b) EAS 10 "Fixed assets and their depreciation" (corresponding to IAS 16): Paragraphs 31–42 of this standard on the revaluation model have

- been modified, as this model cannot be used except in certain cases, and when it does not contradict the laws and by-laws. Otherwise, the entity should use the cost model as provided in paragraph 30 of IAS 16;
- (c) EAS 19 "Disclosure in financial statements of banks and similar financial institutions" (corresponding to IAS 30 which has been superseded by IFRS 7):
 - (i) Paragraphs 44, 51 and 52 of this standard have been omitted, as they prohibit forming a general provision for loans and borrowings as a deduction from profits and losses (expense item), instead stipulating that this provision must be formed as a deduction from the owners' equity (reserve). According to the regulations of the Central Bank of Egypt and generally accepted Egyptian banking practices, however, this provision may be treated as an expense, and is therefore deducted from revenue before calculating profits and losses.
 - (d) EAS 20 "Accounting rules and standards for financial leasing operations" (corresponding to IAS 17).

This standard is different from IAS 17 for leasing, as the Egyptian Financial Leasing Act No. 95/1995 issued by the Minister for Economics and Foreign Trade stipulates a completely different accounting treatment from that widely used internationally (Articles 24 and 25), under which the lessor records the leased asset in his books and depreciates it, while the lessee records the value of the payments of the leasing contracts in the profits and losses as expenses in the period in which they are paid.

Despite the fact that EAS are based on IFRS, there is a delay in the implementation of new standards. There is also a delay in the issuance of implementation guidance for standards. This is due to a lengthy issuance process for local standards. Significant amounts of training and education for financial statement preparers and auditors of small local companies are needed. A lesson learned from the initial implementation is that these groups do not understand accounting standards sufficiently (The United Nations, 2010).

CONCLUSIONS

The main objective of this study was to introduce a historical review of the evolution of accounting practice and thought in Egypt. This review illustrated that since ancient times, Egypt used papyrus in writing which allowed more extensive records to be employed. During that time, the idea

of bookkeeping was initiated, particularly for the network of royal storehouses within which the “in kind” tax payments were kept and to monitor the conversion of inputs into outputs in bread making. The concepts of accountability, governmental accounting, tax accounting, and internal auditing and control system were also initiated.

Following the Pharaoh era, the Greek and Roman Empires ruled Egypt from 332 B.C. to 639 A.D. Both empires had superior accounting practice which they did not transfer to Egypt. They only used accounting as a tool to obtain more tax as a source for the empires’ expenditures. Islamic civilization affected the accounting practice in Egypt through establishing the job of accountant (*Muhtasib*), setting the concepts of full disclosure and social accountability, and replacing lenders with shareholders.

Significant development in the history of accounting in Egypt began in 1883, when the Commerce Act was issued. The accounting goal at the beginning of this stage focused on bookkeeping as a tool of having evidence. The accounting profession was recognized in Egypt in the period between 1914 and 1938, when the Egyptian courts officially recognized accountants as professionals, and the Egyptian government issued an important regulation concerning accounting disclosure in corporations. During the period from 1939 to 1952, accounting as a profession and as a thought grew and developed considerably. Three factors led to this development: (i) issuance of several legislations; (ii) increasing the number and size of corporations; and (iii) the formation of the Egyptian Royal Society for Accountants and Auditors. After 1952, accounting gave more attention to the macro level than to the micro level, and national accounting emerged in Egypt. During the period between 1961 and 1974, accounting was mainly used as a tool serving the national planners.

The most important evolution of accounting practice and thought took place after 1994, when Egypt transformed to a market-based economy, and adopted the IAS.

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CHAPTER 2

IRAN

Zabihollah Resaee and Gholamhossein Davani

INTRODUCTION

Accounting practices have roots dating back as far as human urbanity, and is married to the development of sophisticated transactions in civilizations. Archaeologists have discovered documents that suggest, at least 10,000 years ago (8000 B.C.E.) scratches on stones had been used to record transactions and exchanges (Basu & Waymire, 2006). Accounting, in conjunction with other sciences, is a response to the requirements of human development and demand for achieving socioeconomic objectives. Accounting has become a practical tool for economic and social development around the world. Furthermore, fundamental changes and events have shaped the development and implementation of accounting practices. Accounting has a long antecedent in Iran, where petrography discovered from Elam's Civilization in Susa located in the south of Iran (3000 B.C.E.) shows thousands of years of accounting history during the Hakhmaneshian–Perspolis Empire in Iran (Kazemi, 2011a). The history of accounting in Iran is mostly event-oriented and was influenced by prevailing ancient empires and government regimes, as well as changes in culture, politics, and religion.

The first practical guide book was entitled *Essential Science of Accounts for Bookkeepers and Merchants*, by Mohammad Abouvafai Bozjani in the 10th century A.D. Iranian accountants provided and used special methods of accounting later, which was called “SIAGH.” Professional rules and ethical conduct for auditors and government accountants were developed

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Fig. 1. Cover Page of Kharazmi's Book.

and published in the *Foroughestan* book during the 11th century A.D., and is often referred to and best known as *Mostoufi* (Kazemi, 2011b).

Many Iranians believe that they invented accounting because the fundamentals of accounting are mathematics, of which, the father was an Iranian scholar, Musa Kharazmi. Iranian mathematics has its roots to earlier traditions, most notably ancient Indian mathematics, which had a direct influence on Muhammad Musa Kharazmi (c. 780–850). Kharazmi learned Indian mathematics and introduced it to the Muslim world through his famous arithmetic text, *Book on Addition and Subtraction after the Method of the Indians*. He later wrote *The Compendious Book on Calculation by Completion and Balancing*. Fig. 1 shows a snapshot of the cover page of this book. Modern accounting and auditing in Iran, like that of other countries, gradually evolved to satisfy the financial information need of the Iranian businesses and capital markets.

We first present a brief history of Iran and current status (see box, “Iran at a Glance”). The remainder of this chapter is organized as follows:

1. Accounting before the Islamic statehood in Iran.
2. Accounting after the Islamic statehood to the 1900 era.
3. Accounting from the 1900 era to World War I.
4. Accounting after the World War I.

5. Accounting from 1960 to present.
6. How auditing formed in Iran.
7. History of accounting professional associations in Iran.
8. Future of accounting profession in Iran.

IRAN AT A GLANCE

Iran, better known as Persia, is officially the Islamic Republic of Iran, which is a country in the Middle East located in Central Eurasia and Western Asia with a population of about 75 million. Iran has a very rich and traditional civilization with the existence of ancient cultures and urban settlements in the centuries before the earliest civilizations found in Mesopotamia in 8000 B.C.E. The first Iranian dynasty was developed during the Elamite Kingdom in 2800 B.C.E. Iran was formed as an empire in 625 B.C.E. and further advanced into the Achaemenid Empire, the Hellenic Seleucid Empire, the Parthians Empire, and the Sassanids Empire before the Muslim conquest in 651 A.D. In 1501, Iran was reunified by the Safavid dynasty and adapted Twelve Shi'a Islam as the official religion. Iran's first parliament was formed in 1906 by the Persia's Constitutional Revolution within a constitutional monarchy. Following the Iranian Revolution in 1978, Iran became the Islamic Republic of Iran on April 1, 1979. Iran is divided into 31 provinces and has 241 towns and cities. Iran's capital and largest city is Tehran, located in the northern part of the country. The country's population, while technically and linguistically diverse, is almost entirely Muslim. For centuries, the region has been the center of the Shia branch of Islam. Nearly all of Iran's numerous rivers are relatively short, shallow streams unsuitable for navigation. The country's only navigable river, the Karun, flows through the city of Ahvaz in the southwest.

More than half of Iran's international borders of 4,430 km (2,750 mi) are coastline, including 740 km (460 mi) along the Caspian Sea in the north and 1,700 km (1,100 mi) along the Persian Gulf and adjacent Gulf of Oman in the south. Both the Caspian Sea and the Persian Gulf have important ports and contain extensive underwater deposits of oil and natural gas. Iran's extensive petroleum and natural gas deposits are located primarily in the southwestern province of Khuzestan and in the Persian Gulf. Iran also has one of the world's largest reserves of copper, iron, aluminum, chromites, gold, manganese, silver, tin, and tungsten.

ACCOUNTING BEFORE THE ISLAMIC STATEHOOD IN IRAN (3200 B.C.E.–625 B.C.E.)

The ancient history of accounting in Iran was documented in tablets discovered between 3200 and 625 B.C.E. A large number of discovered Persepolis fortification tablets, similar to those in Fig. 2, provide evidence of ancient Persian cuneiform administrative and accounting documents written between 506 and 497 B.C.E. These tablets are the source for the study of the accounting history in Iran during the Achaemenid Empire. Persepolis was selected by Darius I (a.k.a. Darius the Great) in 518 B.C.E. as the capital of the ancient Persian Empire. More than 25,000 Persepolis tablets were excavated by the Oriental Institute of Chicago in 1930s; they are collectively known as the *Persepolis Fortification Tablets* (Briant, Henkelman, & Stolper, 2008). Some of these tablets are also called the *Persepolis Treasury Tablets*, which clearly relate to economic and business transactions describing payments in silver and liters of barley between 492 and 458 B.C.E.

The economic developments initiated during the Sassanid Empire were built upon its predecessor regime of the Parthian Empire and soon became a powerful and prevailing force that spread beyond the Iranian kingdom and affected other countries at that time (Gyselen, 2011). The Sassanid Empire was regarded as a centralized state, developed based on two economic philosophies, human and natural capital, which determined the economic



Fig. 2. Persepolis Coinages. Source: http://en.wikipedia.org/wiki/Persian_daric (accessed on January 30, 2012).

development during the Sassanid rule (Gyselen, 2011). Natural capital was based on the availability of water, climate, fertility of the soil, richness of the subsoil topography, and streams. Human capital pertained to the activities of administrators, peasants, priests, nobles, and the ruler on behalf of the king, and their international relations with other counties. The discovered archaeologist documents (see Gyselen, 2011) suggest that Sassanid's government promoted private entrepreneurship rather than directly engaging in economic activities. However, the central government collected taxes, levies, and customs. The Sassanid kings (Kavād, Khosrow I Anōšīravān, Ardašīr I) promoted the policy of centralization, installing local officials in different cities as their agents in charge of collecting levies and taxes, and paying related expenses from sources that generated revenues. Agriculture was the main source for economic growth and the lands were distributed to relatives and friends of the rulers and the peasants for agricultural purposes.

The agricultural economy developed under the Sassanids produced crops that included cereals (barley, rye, and millet), fruits (grapes, figs, dates, and nuts), legumes (lentils, chickpeas), fibers for spinning (flax, hemp, and cotton), rice, emmer (hard wheat), apricot, olive trees, and vegetables. This agricultural economy was also supported by raising domestic animals (oxen, sheep, chickens, ducks, and geese) used for labor, meat, milk, and other products. Promotion of the agricultural economy required construction of adequate infrastructure, relevant to irrigation: bridges, dams, wells, and canals (Wenke, 1975). Other agricultural-related industries were also developed during the Sassanid Empire including the drying of fruits, milk processing, preservation of meat, and the transformation of agricultural products (wine making, oil pressing, milling, tanning, weaving, and dyeing) (Idem & Pyne, 1990).

The entire economy, including the physical land, agricultural infrastructure, and other industries, was controlled by the kings of the Sassanid Empire. Thus, taxes and other revenues were collected and payments were paid initially to the king in the form of barley and subsequently in coinage in terms of gold, bronze, copper, lead, and silver. The basic unit of measurement was the *drahm*, which roughly weighed about four grams of silver, and the *dang*, which was a fraction (one-sixth) of the *drahm*. Revenues collected from taxes and other levies for the use of natural resources and payments made to employees, king's servants, mercenary troops, and for other expenses were in *drahms*.

The Sassanid government developed a system of accountability and recordkeeping of all receipts and payments. The king's representatives in

each providence provided an account of taxes (revenues) they had collected on behalf of the king, how they collected taxes and other levies, and how the collected taxes were used to compensate the king's employees and troops. The accountability and stewardship system was developed in order to report to the king the revenues collected and expenses paid. Accounting was established during the Sassanid Empire as a basic recordkeeping function, initially with the use of symbolic artifacts as units of exchange and was subsequently advanced to coinage.

The following sections discuss some of the peculiarities of ancient accounting in Iran, as well as the basic accounting principles, including the calendar, units of measurement, mathematical basics, recordkeeping, bookkeeping, inventory methods, payroll system, monetary system, and budgeting and auditing.

Calendar in Ancient Iran

The appropriate time for planting and harvesting crops has always been very important for humans. Thus, the main effort to determine accurate timing 11,000 years ago was the agricultural divisions of time. A calendar was derived to determine the time of the repeated changes that came about in the world. The most prevalent was the day and night cycle followed by the movements of the Moon around the Earth, and finally the rotation of the Earth around the Sun. This translated into a calendar where a day is the smallest unit of time followed by a month and the solar year.

A solar year is the time it takes for the Earth to revolve around the Sun. The day and night cycle was chosen for the calendar day and the solar year (365 days) for the annual cycle. The Moon rotates around the Earth 12 times in a year for 354 days. A lunar year is eleven days shorter than a solar year and was not used for agricultural purposes.

The Persians adopted the Sassanian Avestan calendar; however, their calendar year had 12 months, each consisting of 30 days or five days less than the solar year. They added one month every 120 years to reconcile the problem. The year with 13 months, called "leap year," was used by religious leaders (Zoroastrian priests) or for tax calculations at that time. Leap year never applied in some eras, e.g., in the period of King Khosro Parviz, and was used as an independent social event. Leap year had ceased after Arab domination and was applied again when the Jalali calendar came about in the Malkshah Saljoughi era.

Units of Measurement

Coins and money had begun in other countries, such as Lydia, and some Greek islands in the Aegean Sea, e.g., Euboea, before the imperial establishment. Stone tablets found from the building in Persepolis show some of the oldest accounting and measurement systems in the Persian imperial. A small part of them dedicates salary and payment systems to the building workers who constructed Persepolis. For example, a “Shakle” was one of the scales of monetary equivalent. A container of “drink” was three Shakles as payment to workers, and a sheep was equal to one Shakle. Fig. 2 is a snapshot of these coinages discovered from Persepolis, which were used during the Achaemenid Empire and King Darius I era as the uniform currency. During the Achaemenid and Sassanid Empires, wages were typically paid in kind, in terms of barley and other goods. Nonetheless, events and transactions were recorded in terms of coin (currency) for the purposes of recordkeeping and managing operations.

Mathematical Basics

One of the most famous mathematical science systems in old Persia was discovered from tablets in Susa by a French scientific group (Kazemi, 2011a). These tablets are in the Babylonian language and date back to the early second millennium B.C.E. They contain information about the mathematics the users used, i.e., numbers, fractions, algebra, and geometry. Results from studying the tablets clearly show they never used the number zero, but instead used a blank space. The counting decimal system employed was base-60 system instead of currently used base-10 system. For example, if a transaction had 54 and 49 units, it was rounded up to 60 and subtracted 6 from the 49 to calculate the results, as illustrated below:

$$54 + 49 = 103[(60) + 43] \text{ or } 83 - 45 = 38[(60 + 23) - 45]$$

These tablets are in different shapes (circle and triangle) and go back to about 1,400 years before the Pythagoras theorem. Some sections among the tablets considered a ratio the division of money between different people. Mathematics is the basis of accounting and, as noted above, the father of mathematics was Muhammad Musa Kharazmi (c. 780–850), an ancient Iranian scholar. The Greeks created a geometric algebra where terms were represented by sides of geometric objects, usually lines, that had letters associated with them. Diaphanous (3rd century A.D.), sometimes called

“the father of algebra,” was an Alexandrian Greek mathematician and the author of a series of books called *Arithmetical*. These texts deal with solving *algebraic equations*. The word “algebra” comes from the Arabic and Farsi languages and translated literally means “restoration.” Many of the algebra and geometry methods come from Iranian mathematics, and its roots can be traced to earlier traditions, most notably ancient Indian mathematics. The latter had a direct influence on Kharazmi, who learned Indian mathematics and introduced it to the Muslim world through his well-known *Book on Addition and Subtraction after the Method of the Indians*, and who later wrote *The Compendious Book on Calculation by Completion and Balancing*, which established algebra as a mathematical discipline that is independent of geometry and arithmetic (Kazemi, 2011b).

Recordkeeping, Bookkeeping, and Financial Reports

The earliest documented records of the use of recordkeeping are the tokens of ancient Mesopotamia dating back to 8000 B.C.E. (Ifrah, 2001). Documents discovered by archaeologists in Persepolis (ancient Iran) include Castle tablets (Fortifications) and tablets of Treasury, written between 506 and 497 B.C.E., showing they were used to record transactions and exchanges. These tablets were discovered in 1933–1934 and 1936–1938 by American explorers in Persepolis, which was one of the capitals of the Achaemenid Empire (founded by Darius I (a.k.a. Darius the Great) in 518 B.C.E.). The Persepolis Fortification Archive and Persepolis Treasury Archive are two groups of clay administrative archives, i.e., sets of records physically stored together, which are found in Persepolis (Old Persian: *Pārsa*; in Greek meaning “City of Persians”; Modern Takht-e-Jamshid in Fars near Shiraz in southwestern Iran), dating to the Persian Achaemenid Empire. The discovery was made during legal excavations conducted by the American archaeologists from the Oriental Institute of the University of Chicago in 1933.

While the political end of the Achaemenid Empire is symbolized by the burning of Persepolis by Alexander the Great, the fall of Persepolis paradoxically contributed to the preservation of the Achaemenid administrative archives that might have otherwise been lost due to the passage of time, natural and man-made causes. According to archaeological evidence, the partial burning of Persepolis did not affect the Persepolis Fortification Archive tablets, but may have caused the eventual collapse of the upper part of the northern Fortification wall that preserved the tablets until their recovery by the Oriental Institute’s archaeologists.

Thousands of clay tablets, fragments, and seal impressions in the Persepolis archives are a part of a single administrative system representing the continuity of activity and flow of data over more than 50 consecutive years (509–457 B.C.E.). These records can shed light on the geography, economy, and administration at that time, as well as the religion and social conditions of the Persepolis region, the heartland of the Persian Great Kings from Darius I to Artaxerxes I. Further refinements of using numerals and written language in recordkeeping by the Sassanid Empire around 3200 B.C.E. were observed in the discovered tablets (Nissen, Damerow, & Englund, 1993). During the administration of King Darius I the Great, the recordkeeping of accounting was extended to bookkeeping, as records were stored in written language to facilitate classification and measurement. Written receipts were also used to resolve disputes and as evidence in legal proceedings by kings. Similar evidence of using recordkeeping to resolve legal disputes is also documented by the Athenians in the 3rd century B.C.E. (Sickinger, 1999). The use of written language and numerals in ancient Iran is the first manifestation of the development of single-entry bookkeeping thousands of years before the Italians established the original double-entry bookkeeping system in the 13th century (Pacioli, 1494).

Inventory Methods

The clay tablets discovered in Persepolis demonstrate a classified system keeping track of foods, goods, and materials in inventories (Kazemi, 2011a). The inventory custodian, who was typically the king's representative, maintained a record of how much flour, meat, and drink was used for personal use and by other companions, colleagues, and subordinates. The cost of each inventory item was recorded on a clay leaf.

The custodian made a tablet by clay and pressed one side of clay on the board to make it flat then the supervisor sealed the left side of tablet to approve it. This tablet, as well as other forms, was then afterwards delivered to storage. They carefully marked the clay tablet for each item of good with special nails and an inventory manager sealed the form to confirm it. The receiver always pressed his seal on the bottom or back side.

In addition, they sealed two tablets (an original and two copies), one for local filing and a copy was sent directly to Takht-e-Jamshid, the capital. Saving documents for an inventory system had never been simple for staff, and scientists assume they were set tablets in labeled baskets by date and place. Some labels have been found with the name of an item, place of document,

name of employee, and date received. This inventory system shows that the custodian was required to keep track of items received and used.

Payroll System

The tablets discovered in Persepolis provide useful information about the payroll system from Darius the Great's era. Wages were paid based on the employee qualification and job classification. Royal employees were classified into two different categories of masters, regular workers and servants.

Workers were mainly paid with barley and drink. The base amount was three "Bon," as a minimum wage for a worker in a month. Each Bon had matured to 10 Daghe. A Daghe is the smallest payment amount, which is close to one liter (about 97%), and is hardly enough for baking one pound of bread. The salary was set at the same amount for servants and general labor. Wages were adjusted based on age and experience where older and more experienced workers were paid above the stated minimum wage. Wages were determined based on specialization, ethnicity, and age, where elder, accountants, and Persians were typically paid a higher salary.

Foreign workers who were from Lykeh, Tarakieh, and Balkh received the minimum wage. Most of these workers were used for the harvesting season, moving where demand was needed in certain areas to other regions. The Babylonian called "Guard of Grains" was responsible for keeping and sowing the seed. The Trakyan were assigned for animal husbandry and the Syrians for Cedar wood protecting. All workers received the minimum wage, with an additional bonus of one Daghe of barely and half drink, which was paid every two months.

The salary of the top-ranked group, which included the main chief and the core of the government, included: 5,400 liters of barley, 2,700 liters of drink, and also 60 goats or sheep for a month. We know that "Frankeh," Darius's court chief, had that amount as salary for many years. The only person who received more drink (3,000 liters in a month) was Geobrohe, Darius's father-in-law. He had overthrown Geoumate and gave power to Darius. Chiseh-v-hosh was the second man in court and he received 900 liters drink and 1,800 liters barley, one-third of Frankeh's salary, but more meat, and 45 goats or sheep.

This payroll method of paying wages in kind by merchants, such as barley, drink, and goats, became difficult to manage as more employees and workers started to work in the kingdom. Thus, silver coins were used to

compensate employees for at least a third to half of salary instead of drink and meat. Tablets often show silver for salary in the time of “Khashayar sha” (486–465 B.C.E.) and the government beginning Artaxerxes (465–424 B.C.E.). Cash payments (silver) were more fair and objective and were preferred by employees primarily because of the variety and difficulty in the quality and quantity of distribution of meat, goats, or sheep.

Documents available today, that try to clarify the actual level of income at the time of the Achaemenid, are convoluted with a large amount of inalienable rights, which was classified by skills and work times. Wages were determined by performance and additional payments (bonuses) were given for high performance. Therefore, the minimum payment of ordinary wage was just 20 liters in a month in Mesopotamia before Achaemenid. The minimum amount was equal for all laborers: clerks, gardeners, tailors, farmers, pottery makers, carpenters, blacksmiths, and saddlers. The most important addition in the Darius era was extra payment for workers, which included government staff and hard jobs, and to women who had children or were pregnant. Rights of men and women were equal. Males and females were working together, training, and receiving job promotion opportunities equally. The number of female managers and supervisors was enormous (about 30%) according to the discovered documents (Kazemi, 2011a).

Monetary System

The development of trade expansion necessitated the establishment of a uniform monetary system. The Achaemenid was encouraged to establish a currency infrastructure to make coinage as a unit of exchange in order to facilitate business and trading. The country of Lydia and the island of Agita in Greece were documented to be the first countries to use coinage for trades. However, coins (gold and silver) had existed before the Achaemenid Empire in Iran and were differentiated into a similar monetary system.

Taxes and Budgeting

There is little documented evidence about economic and budgeting policies of the Iranian government in the Achaemenid era. The only source of comprehensive information that the Achaemenid economic period has presented is a book called *Economies* (Kazemi, 2011a). During the Achaemenid and

King Darius I era, the government was responsible for balancing its budget in a manner that responded to financial challenges, while not burdening its citizens with heavy pressure of meeting their financial needs. During the Achaemenid era, the government acquired revenue from many different sources. The *Economies* book refers to the six sources that include: anthrax, gifts, benefits from commercial property, real estate taxes, business taxes for industries, and consultation with the state governors to determine the source of anthrax in the Darius eras.

Darius was the first king who published public statements to inform all of the regions about the tax rates in other states. Earning money in addition to the commodity economy had a fundamental role in the economic development in the Darius eras.

The main source of Sassanid income was generated through taxes imposed on citizens according to their income brackets. The tax rate was assessed according to the harvest of the lands, where high-quality lands were assessed a higher tax rate than low-quality lands. First, Qobad began the valuation of land and farms for tax assessment purposes and then King Anoushirvan completed that reform to make a direct tax system that expanded to all regions based on the fair value of lands, and also counts and values of olives and palm trees. This new approach gave the king unprecedented power to implement his governmental policies and economic developments, as well as controlling the citizens and initiating foreign policies. For example, through this fair and equitable tax system, the funds generated from imposed taxes were utilized to develop agricultural equipment and irrigation dams to increase farmers' income. After the Anoushirvan era, Khosro introduced a special financial and tax system, which facilitated strong economic performance for Arabs in Omavian and Abbasian times (Kazemi, 2011b).

Audit Methods

The Achaemenid control system was established to gather evidence, retain documentation, and assess performance. All states and providences were required to prepare and submit performance reports to the central government every two months. This process was monitored under the Persepolis central control. Some of the discovered tablets indicate that some documents were filed and reports were summarized either bimonthly or yearly. For example, the discovered tablets indicate that all reports from the Kurd-o-shoom Elamite region were prepared for every other month in year

22 (509 B.C.E.) (Kazemi, 2011a). Comprehensive reports are available from collected individual documents, including samples of documents for the annual report. In this report, all receipts and payments are summarized in a year. Annual or bimonthly reports were normally in more detail and contained more information than other reports. Confirmation of the balance sheet was verified by three auditors to ensure the credibility of reports and decrease auditing risks. They have titles for auditor's positions with both Persian languages and the Elamite. The origin of auditing in Iran can be dated back to the Sassanid Empire, and was conducted whenever the kingdom's resources were entrusted to others to ensure accountability. This type of audit was done by the king's investigator, who mediated between the king and his agents. The evidence of auditing and internal control system is also found in other countries during this time period, including ancient Mesopotamia, India, Rome, and Greece (Stone, 1969).

There were three layers of audits, with individuals responsible for each layer. For example, we can see the names of people in reports, such as drink keepers or drink carriers, who were responsible for the control of drinks. The second level of audit was conducted by a person who was called the general inspector. The general inspector was typically the official clergy of the central government in charge of verifying performance, ensuring the effectiveness of controls, and vouching for the accuracy of documents and reports. However, King Darius promoted this position as an effective monitoring function in addition to practicing religious requirements. The third auditor was in charge of both the custody and control of resources. In some special occupations, another auditor was employed to audit all accounts in each state who typically audited the year-end transactions as well as those of the first month of next year. Auditors were never able to audit all of the accounts and sometimes audited only one or two accounts that needed more consideration.

ACCOUNTING AFTER ISLAMIC STATEHOOD TO 1900 ERA

The Islamic conquest in Iran after the Sassanid Empire not only caused a religious conversion to Islam, but also influenced socioeconomic conditions, including accounting and auditing. The primary purpose of Islam was to ensure fulfillment of responsibilities of the Islamic State to promote socioeconomic objectives of Islam.

The primary driver of Islamic accounting – the religious requirement of Zakat (religious levy) – was determined based on the current value of assets and revenues. Islamic accounting practiced in Iran was an integrated reporting derived by religious, social, political, and economic domain ruled by Allah (Islamic rules, Shariah law). Islamic accounting recognized only lawful (*Hala*) transactions and not unlawful (*Haram*) transactions (interest on credit). Except for the two relatively small governments of Safavid and Afsharian, there is not sufficient evidence of strict compliance with the Shariah law in Iran for financial reporting purposes. The information from the early Islamic state shows that the Barmaki brothers (Yahya and Jafar Barmaki) made detailed financial systems in the government of Harun al-Rashid for proper recording of revenues collected and expenses incurred from business transactions.

Pursuant to the 1979 Islamic Revolution in Iran, the financial reporting process and financial markets in Iran are influenced by the Shariah law as interpreted by the Shariah Board established in 2006 (IICM, 2009). The Shariah Board consists of seven jurisprudents, financial, legal, and economic experts, knowledgeable in financial and capital markets. The Shariah Board oversees capital markets and the financial reporting process to ensure compliance with Shariah rules and objectives. The Shariah Board is responsible for approving the design and use of Islamic financial products (financial instruments).

ACCOUNTING DURING THE 1900 ERA TO WORLD WAR I

During the Qajar Empire in the 1900s, fundamental changes in the Iranian financial reporting process were made with the help of two American advisors, Showartskuf and Morgan Shuster, who provided military and financial consultations. Shuster attempted to overhaul the Iranian financial and tax systems by integrating the Anglo-American financial and tax procedures into the Iranian financial and tax systems (Davani, 2002). However, after the Russian Ambassador Gribaidoph was killed in Iran, the Russian government gave an ultimatum to the Iranian government to force Morgan Shuster out of Iran.

Shortly after, Dr. Arthur Millispo, an American specialist, was invited to help the Ministry of Finance and Customs improve its financial, tax, and tariff systems. Exploration of oil and gas in Iran, establishing the

Anglo-Iranian Oil Company and related international banks in the late Qajar period, opened up new opportunities to adopt the American financial reporting system in Iran. Nonetheless, the advanced American accounting systems were limited to a handful of high-profile American-connected institutions and companies that did not have widespread influence in the Iranian financial system. During the Qajar period, the development of the accounting and financial reporting process in Iran was primarily influenced by the presence of American financial advisers and American-connected firms and institutions in Iran.

ACCOUNTING FROM WORLD WAR I TO THE EARLY 1960s

The modern era of accounting and auditing in Iran was initiated after 1953, particularly following the economic reform in 1960. The reform happened after a period where Iran had persisting deterioration in the economy, a huge budget deficit, substantial foreign debts, and significant corruption in the government. Several laws, rules, and regulations were passed by the National Assembly to address these challenges. In this period, the country's first budget and tax law, the Commercial Law (Commercial law for acceptable bills and discounted notes) was passed by the National Assembly in 1949. Subsequently, in 1950, the National Assembly considered and approved the first Law of Government Accounting and Public Accounting (Audit Law Public Act). These commercial, tax, and financial laws have shaped modern accounting and auditing in Iran.

The first initiative to address accounting and auditing education in Iran was taken when a group of accounting students were sent abroad to learn modern Western accounting. A group of 12 accounting students, who were selected through entrance exams in the specialized field of accounting, were sent to England in 1942. Among these graduates were Hassan Sajjadi Nejad and Esmail Erfani, who are regarded as pioneers in modern accounting in Iran. The visionary efforts of these and other accounting scholars, mainly educated abroad, encouraged the National Oil Company of Iran to establish an accounting school in 1957. The school became the Faculty of Accounting and Financial Sciences, which established graduate level courses in 1975. Subsequently, other educational institutions, such as the Institute of Banking Sciences, College of Business, College of Administrative Sciences of the University of Tehran, and National University of Iran, had integrated

accounting programs into their business curriculum. The modern accounting and auditing practice and education in Iran, including teaching accounting courses at the college level, were initiated and promoted by the aforementioned educational institutions during this era.

ACCOUNTING IN IRAN SINCE THE EARLY 1960s TO PRESENT

The fast-growing economic developments in Iran promoted the move toward industrialization and privatization of business and the promotion of Western business in Iran in the late 1960s and early 1970s. This necessitated the advancement of modern accounting, auditing practice, and education in Iran. The industrialization and promotion of entrepreneurship, including the emergence of large industrial groups such as Melli shoes, Behshahr Industrial Group Co., and several car companies such as Jeep (Pars Khodro), Iran Khodro, SAIPA Co., and Zamyad, as well as foreign investments by multinational companies, demanded more relevant and advanced financial reporting systems. The traditional accounting systems became less relevant and responsive to the demand for more accurate and complete financial information to measure performance and manage financial activities of emerging multinational companies in Iran. Similar demand for more advanced accounting systems in other countries is documented in the accounting literature (Ijiri, 1975).

The growing demand for modern management and accounting systems in identifying, classifying, measuring, recognizing, and preparing financial reports to satisfy the financial information needs of multinational and national companies in Iran during the early 1970s encouraged international consultants, financial services firms, and public accounting firms to invest and expand their operations in Iran. All eight large international accounting firms at that time (Arthur Andersen, Arthur Young & Co, Coopers & Lybrand, Ernst & Whiney, Deloitte Haskins & Sells, Peat Marwick Mitchell, Price Waterhouse, and Touché Ross) opened offices and practiced accounting and auditing in Iran. These accounting firms played an important role in redesigning financial and managerial accounting in a variety of industries and contributed significantly to the development of the new accounting systems in Iran.

The first Iranian institute that promoted and advanced new management accounting concepts and improved methods of management and

administrative information systems was the Industrial Management Institute (IMI), which was formed and approved by the Committee of Ministers (Davani, 2010). The IMI also provides many services in training and research in financial and management accounting, including the establishment of the first MBA program in Iran. The use of a computerized accounting system began in large national and international companies, such as the National Iranian Oil Company (NIOC) and IBM, during the late 1960s. They were used in operational and inventory systems first and then moved into payroll and salary systems. The first specialized vocational accounting school, the Iranian Institute of Advanced Accounting (IIAA), providing educational research and practical training in financial, managerial, and governmental accounting, as well as auditing, was founded by Dr. Aziz Nabavi, a leading Iranian scholar, in 1961. For many years, IIAA was the largest private accounting school in the Middle East, with more than 6,500 graduates in the fields of auditing, financial accounting, and governmental and managerial accounting (Alimadad & Molkarai, 1998). After the Islamic Revolution in 1979, all private accounting and auditing firms, including the Big Eight, were dissolved, and their expert staff were attracted to other organizations and institutions.

The National Industrial and Plan Organization Audit Firm (NIPOAF) was formed in 1980 to audit nationalized entities. The Centre for Professional Accounting and Auditing Studies, the research wing of NIPOAF, issued guidelines and set requirements for companies that needed sound and effective financial and management accounting systems. The Audit Organization was established by an especial act of parliament in 1987 to embody four exiting large audit firms, namely (i) Audit Company (est. 1971), (ii) NIPOAF, (iii) Mostazafan Foundation Audit Firm (est. 1983), and (iv) Shahed Audit Firm (est. 1984). One of the functions of the Audit Organization is setting national accounting and auditing standards.

HOW AUDITING FORMED IN IRAN

The concept of auditing in Iran was not driven from economic development, formation of entrepreneurship, or formation of public companies. It evolved to be consistent and in compliance with auditing requirements of developed countries. In other words, auditors and inspectors were employed to ensure that organizations complied with regulatory requirements rather than adding value to the financial reporting process. Various laws and regulations have shaped modern auditing in Iran. First, the Iranian Business

Law was adapted from Belgian business law in 1931 and required public companies to appoint one or more inspectors from shareholders or outsiders in order to examine company accounts, documents, and financial statements (Davani, 2010). Although these appointed inspectors were required to examine the company accounts, records, and documents, they did so rarely. Inspectors examined books and records based on conventional evidence-gathering procedures and did not express any opinion accurately or completely, nor opined on fair presentation of financial statements.

Second, the most important law that influenced the auditing profession in Iran was the enactment of the first Iranian income tax law in 1949 (Golestaneh & Aghajani, 1996). This tax law, which was amended several times (1957, 1961, and 1963) by the Ministry of Economic Affairs and Finance, had a direct impact on accounting and auditing. The law required that companies of all sizes and types operating in Iran maintain adequate accounting records for tax purposes and that their financial reports, including tax returns, be audited and certified by a certified public accountant. This created jobs for accountants and auditors in Iran and is regarded by many as the "Accountant Full Employment Law."

Third, regulations pertaining to the practice of public accounting in Iran were established in 1967 to set requirements for admission to the accounting profession (Talanah & Pooryanasab, 1995). The process of obtaining certification, roles and responsibilities of practicing public accountants, and professional standards were set to improve audit quality and ensure compliance with all applicable tax laws, rules, regulations, and accounting standards.

Fourth, in addition to the use of professional accounting in tax services, the Commercial Law Amendment (on corporations) Act (1989) required corporations to provide income statements and balance sheets that were audited by certified public accountants (CPAs). Certified public accountants were also obliged not only to give an opinion on financial statements, but also to report any adjustments suggested by the auditor regarding financial statements to reflect the true picture of the company's finance position.

The first Iranian auditing firm was established in 1961, and the number of private auditing firms had grown substantially to more than 40, which included Iranian partnerships in the Big Eight international auditing firms within a short time period, before they were all dissolved right after the Islamic Revolution in 1979. Many of these auditing firms cooperated with their counterparts and international auditing firms in other countries.

Fifth, pursuant to the Islamic Revolution, the Iranian government owned the majority of businesses. These government-owned companies started

showing significant profits, so the Nationalized Industries and Plan Organization Audit Firm was created by the government to audit government-owned companies.

Finally, the Tehran Stock Exchange (TSE) was established in 1967, which required listed companies to have their financial statements audited by independent public accounting firms (TSE, 2011). The TSE listing requirements have promoted interest in and demand for private public accounting firms in Iran. The Securities and Exchange Organization (SEO) of Iran was established in 2006 under the Securities Market Law as the main regulatory body in Iran to oversee Iranian financial markets and regulate activities of financial services firms in compliance with Shariah Law (SEO, 2011). The SEO is governed by its board of directors, which is elected by the Securities and Exchange Council, which is the highest authority in charge of establishment policies, market strategies, and supervision of Iranian capital markets. The chairman of the Council is the Minister of Economic Affairs and Finance; other members are the Minister of Trades, the Governor of the Central Bank of Iran, the Managing Director of the Chamber of Commerce, the Attorney General, and the Chairman of the SEO. These market regulators also oversee the accounting and auditing profession in Iran.

The early stages of accounting in Iran were regarded as a type of investigative forensic accounting, and was primarily concerned with the accuracy of recordkeeping. In most cases, all sales and revenue transactions, as well as related expenses, material in nature, were examined. Auditors also looked for understatements of revenue by vouching for omitted sales and overstatements of expenses.

The focus of auditing gradually changed focus from income-statement quality to balance-sheet quality, as many companies obtained their financing from government-sponsored institutions and banks. As financial institutions in Iran became major users of audited financial reports, the primary objective of auditing became the proper and fair valuation of assets in the balance sheet. The establishment of the TSE in 1967 refocused the major objective of audits of financial statements to the examination of the balance sheet, income statement, the statement of cash flows, and the statement of owners' equity.

Audit of profit and nonprofit entities, a system of professional accounting, establishment and domain of nongovernmental auditing, were left undecided for the first 10–15 years after the revolution. The Use of Specialized and Professional Services of Qualified Accountants as Certified Public Accountant Act (the Act), enacted in 1993, was a desirable response to

this need. According to the Act, the government may utilize the specialized and professional service of CPAs as it thinks proper and fit, to monitor financial affairs of manufacturing, trading, and service entities, and also to ensure the reliability of their financial statements in order to maintain investors, other interested parties, and the public interests.

According to sub-section 1 to the Act, the "Recognition of Qualification of Certified Public Accountants" procedural manual was ratified in 1995 by the Council of Ministers, and, in early 1996, the Minister of Economic Affairs and Finance introduced the first group of CPAs as founders of the Iranian Association of Certified Public Accountants (IACPA) to develop the association's articles of association, which were ratified by the Council of Ministers in September 1998.

The first general assembly of CPAs was convened on August 24, 2001, to elect High Council members. High Council members were duly elected by direct vote of CPA members and the Association was duly established on January 31, 2002.

The auditing profession has undergone significant changes and refinements in the past five decades. The overriding objective of auditing was moved from investigation of earnings management schemes intended to minimize taxable income to render opinions on the fair presentation of financial statements with a keen focus on proper income determination and the fair valuation of assets. Various government agencies played a role in the advancement of modern auditing in Iran. Table 1 presents chronologically the events that have shaped the auditing profession in Iran during the past several decades.

HISTORY OF ACCOUNTING PROFESSIONAL ASSOCIATIONS IN IRAN

The establishment of professional associations typically gives group recognition to its members as professionals and promotes their competency and professional services. In the early 1960s, a small visionary group of Iranian scholars, mostly educated abroad (the United States, the United Kingdom, and Canada), got together and discovered they had a mutual interest in advancing the accounting profession, auditing practice, and education in Iran. The Ministry of Finance, based on Article 33 of the tax law of 1949, authorized the establishment of Iranian professional

Table 1. Chronology of Events in the History of the Iranian Accounting Profession.

Year	Event
1311 (1932) (enactment of business law)	Appointment of Inspector to examine the accounts and documents of companies
1326 (1947) (the tax law amended)	Use of public accountants services in matters of tax documentation was permitted
1328-1335 (1949, 1956) (income tax law enacted)	Acceptance of the results of the "Accountant Under Oath" examinations concerning the accounts or balance sheets of businessmen and companies for tax assessment purpose
1340 (1961)	Approval of operating regulations for the use of "Accountants Under Oath"
1341 (1962)	Formation of the first association of "Accountants Under Oath"
1342 (1963)	Approval of the articles of association of the Center "Accountants Under Oath" Centre
1343 (1964)	Foundation of the Iranian Accounting Association
1345 (1966) (enactment of the law of direct taxes)	Formation of the "Center of Public Accountants"
1346 (1967)	Approval of regulations governing the selection of public accountants
1347 (1968) (amendment of business law)	Requirements for the use of public accountant's report
1349 (1970)	Approval of operational regulations governing the appointment of persons licensed for the inspection of corporation- type companies
1350 (1971)	Foundation of the Audit Company
1351 (1972)	Use of public accountant's report is made a requirement/ approval of the Articles of Association of the Center of Public Accountants
1359 (1980)	Foundation of the Nationalized Industries and Plan Organization Audit Firm Audit Institute Under the Organization of National Industries and the Planning and Budget Organization
1362 (1983)	Enactment of the law decreeing the Establishment of the Iranian Audit Organization
1366 (1987)	Approval of the Articles of Association of the Audit Organization
1372 (1993)	Enactment of the law decreeing the Establishment of the Iranian Audit Organization
1374 (1995)	Approval of the regulations governing the determination of the public accountant's qualifications
1378 (1999)	Formulation of the Iranian Association of Certified Public Accountants Articles of Association

Table 1. (Continued)

Year	Event
1379 (2000)	Formulation of the regulations governing the use of the public accountant's services and reports
1379 (2000)	Formulation of guide for elections to the supreme council of the Iranian Association of Certified Public Accountants
1380 (2001)	Announcement of the first group of public accountants and the convening of the first general meeting of the Iranian Association of Certified Public Accountants
1383 (2004)	The second electing for High Council of IACPA
1386 (2007)	Third election of High Council of IACPA
1388 (2009)	By-Law of Increase guarantees to audit profession
1389 (2010)	Fourth Election of High Council of IACPA

associations and experts in August 1961 (Davani, 2000). Thus, the Iranian Institute of Certified Public Accountants (IICPA) was formed in July 1963. A commission, consisting of representatives from the Ministry of Finance, the Supreme Audit Institute, the Tehran Prosecutor, the Chamber of Commerce, and the Central Bank of Iran, and three professional accountants, was formed to establish certification requirements of CPAs, better known at that time as the "Accountant under Oath." The commission reviewed the credentials of eligible candidates, including their passing scores, and issued certification of CPAs to a group of 36 qualified accountants in July 1963. The Iranian Accounting Association (IAA) was also established on June 30, 2003, to promote accounting education and practice (Davani, 2010).

Iranian Association of Certified Public Accountants

Changes in 1947 to the tax law and introduction of a comprehensive tax law in 1949 emphasized the role of accountants in performing tax services. Article 30 of the tax law required certified accountants to examine a balance sheet or an account of a taxpayer for tax determination purposes, and the opinion could be used as a basis for tax assessment. Article 33 of the law as prescribed in the Ministry of Finance working procedures required CPAs to perform tax services for their clients by certifying related financial statements and records. CPAs that performed tax services were required to comply with the established accounting and auditing guidance, as well as abiding to ethical standards. Despite all efforts by the Iranian

government, the IACPA was not effectively formed or operated during the 1960s and 1970s and was dismantled after the Islamic Revolution in 1979.

The IACPA was reestablished in 2001 as the primary organization in charge of promoting the accounting profession in Iran and was authorized to grant certifications to practicing accountants (Davani, 2002). The IACPA functions very similar to the AICPA. A new feature of the amendments made to the Direct Taxation Act in 2002 was the introduction of the role auditors play in a company. According to Note 1 of Article 272 of the Act, tax reports drawn up by the Audit Organization of the Islamic Republic of Iran or members of IACPA shall be acceptable to the tax authorities without any further investigation of the accounts, books, and vouchers, and shall form the basis for issuing tax assessment (Ministry of Finance and Economic, 2001).

The Act allows the government to utilize the services of a certified public accountant as follows:

1. Audit and statutory examination of companies listed or applying for listing in the stock exchange.
2. Audit and statutory examination of other private or public companies.
3. Audit of other profit and nonprofit entities.
4. Audit and statutory examination of companies and entities specified in Article 7 (a and b) of Articles of Association of Audit Organization, enacted in 1988.
5. Tax audit of individuals and legal entities.

Specialized and Professional Service

Such services are as follows:

1. Audit Services, including various audit engagements.
2. Statutory Examination.
3. Financial Management Consultancy.
4. Financial Systems Design and Implementation.
5. Financial, Accounting, and Tax Services.
6. Insolvency and Liquidation.
7. Services referred to certified accountant by courts and justice authorities within the above services and accepted by the accountant accordingly. The High Council of the Association has the authority to identify other professional services within the provisions of the Articles of Association.

The Objective of the Association

The objective of the IACPA is to regulate and promote the accounting and auditing profession in the country and to oversee the work of members by:

1. Organizing CPAs.
2. Enhancing and developing professional services through preparation, compilation, dissemination and promotion of accounting, financial services, and ethics standards.
3. Enhancing professional knowledge of CPAs through development and improvement of training, research, and issuance of specialized and professional publications.
4. Safeguarding the professional interests of members.
5. Communicating with regional and international professional bodies and becoming a member thereof with the goal of advancement of professional connections.

Governing Bodies

The governing bodies of IACPA are as follows.

General Assembly. The General Assembly includes all CPAs and its duties are: (i) election of the High Council of IACPA and (ii) approval of the annual report.

High Council. The High Council comprises 11 experienced and expert CPAs elected from within the members by the members for a three-year term. One delegate appointed by the Minister of Economic Affairs and Finance, one by the Stock Exchange Council, and one by the High Council of Banks also attend the meeting without voting rights. The High Council is the highest governing body and is responsible for matters such as setting the strategy and approval of plans, manuals, annual budget, financial statements of IACPA, appointment of the board of directors, and disciplinary board members. Approval of specialized committee members' competency, determining entry fees, and performance of professional oversight through specialized committees are part of its duties.

Board of Directors. The Board of Directors comprises three or five CPAs selected from within the members and appointed by the president for three years. The High Council appoints one of the members of the board as Chief Executive Officer and Secretary General, who will handle the Association's affairs on a full-time basis.

Implementation of High Council directives, planning, organizing, preparation of manuals, annual budget, financial statements, and execution

of plans are among the duties of the Secretary General and the board. Each member of the board is responsible for part of the activities of the Association. Other duties of the board include establishing specialized committees, recommending entry, fixed and variable membership fees, and preparation of directives necessary for execution of duties.

Supreme Oversight Board. The Supreme Oversight Board comprises one chief and two members, all CPAs, appointed from within the members of the Association by the Minister of Economic Affairs and Finance for a two-year term. The board has the duties of examining and expressing an opinion on the fairness of information reported by the Board of Directors, the annual financial statements of IACPA, performance of the Association and its members, and also to render regular reports of its activities to the Minister of Economic Affairs and Finance, the High Council, and the Board of Directors as necessary.

The Iranian Institute of Certified Accountants (IICA)

The IICA is a nongovernmental association of accountants in Iran. It was established in 1972 by a group of Iranian scholars and practitioners who were members of the U.K. accounting institutes, with the primary objective of promoting the accounting profession in Iran, and it has continued its professional and educational activities.

At the time of the IICA's inception, the audit profession consisted of one government agency plus a number of indigenous Iranian firms, as well as branches of international firms. There was also an Order of Official Accountants at the time which had been established under the Direct Taxation Act of 1967, and whose members carried out tax audits. The Order of Official Accountants was abolished in 1980, and the IICA remained the only professional association of accountants in Iran. After the end of the Iraq war and the start of reconstruction in Iran, the IICA expanded its activities and a number of research committees on taxation, commercial law, and accounting were formed. The IICA has about 4,950 members and publishes a monthly journal, *Hesabdar*. The IICA has been a member of the International Federation of Accountants (IFAC) since 2000 and also set up a Professional Accountants Centre For Training (PACT) in 2004 with the cooperation of business schools in Iran, which provide all the courses related to training and preparation for professional accounting certification examination.

Iranian Accounting Association

The first academic IAA, similar to the American Accounting Association, was formally established in 1997 by a group of 15 Iranian educators who had trained abroad (Davani, 2002). The primary purpose of the IAA was to provide educational services (seminars, books, and training workshops) for accountants and to advance the accounting profession in Iran. The IAA was subsequently officially registered and began to accept memberships and engage in the development of modern accounting and auditing standards in Iran, as well as promoting ethical standards and practices. The IAA was fairly active in fostering modern accounting education and practices in Iran prior to the 1997 Iranian revolution and has become more active in recent years. After 50 years, the first International Accounting Conference was organized by the IAA in December 2008, and the IAA has continued to sponsor its annual international accounting conference ever since.

IRANIAN ACCOUNTING AND AUDITING STANDARD SETTING PROCESSES

Accounting and auditing standards in Iran are promulgated by the Audit Organization established in 1983. The Audit Organization is a government entity and the largest audit firm in the Middle East (see <http://www.audit.org.ir>, accessed on 30 January, 2012). Traditionally, Iranian accounting and auditing standards have been adopted from those in the United States and the United Kingdom. Table 2 shows the codification of the Iranian National Auditing and Accounting Standards and a comparison with IAS.

FUTURE OF ACCOUNTING PROFESSION IN IRAN: GOING FORWARD

The study of history is important in building a solid foundation and framework to achieve social, personal, career, or business prosperity, and as a basis for developing the future of the accounting profession. Accounting is one of the oldest professions in Iran, which was intended to hold individuals accountable to the king in ancient Iran (8000–6000 B.C.E.). The accounting profession in Iran in recent years has been influenced by many factors, from

Table 2. Codification of Iranian Accounting Standards and its Comparison with International Accounting Standards.

National Iranian Accounting Standards		International Accounting Standards (IAS)	
Standard no.	Standard title	Standard no.	Standard title
<i>Panel A: Iranian Accounting Standards Codification and Comparison with International Accounting Standards</i>			
1	Presentation of Financial Statements	IAS 1	Presentation of Financial Statements
2	Cash Flow Statement	IAS 7, except for (a)	Cash Flow Statement
3	Revenue	IAS 18	Revenue
4	Accounting for Contingencies	IAS 37	Provisions, Contingent Liabilities and Contingent assets
5	Events After the Balance Sheet Date	IAS 10	Events After the Balance Sheet Date
6	Reporting Financial Performance	IAS 8	Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policy
7	Accounting for Research and Development costs	IAS 38	Intangible Assets
8	Accounting for Inventories	IAS 2	Inventories
9	Accounting for Long-term Construction Contracts	IAS 11	Construction Contracts
10	Accounting for Government Grants	IAS 20 except for (b)	Accounting for Government Grant and Disclosure of Government Assistance
11	Accounting for Fixed Tangible Assets	IAS 16	Property, Plant and Equipment
12	Related Party Disclosures	IAS 24	Related Party Disclosures
13	Accounting for Borrowing Costs	IAS 23	Borrowing Costs
14	Presentation of Current Assets and Current Liabilities	IAS 1	Presentation of Financial Statements
15	Accounting for Investments	IAS 25	Accounting for Investments
16	Foreign Currency Exchange	IAS 21 except for (c)	The Effects of Changes in Foreign Exchange
17	Accounting for Intangible Assets	IAS 38	Intangible Assets

Table 2. (Continued)

National Iranian Accounting Standards		International Accounting Standards (IAS)	
Standard no.	Standard title	Standard no.	Standard title
18	Consolidated Financial Statement and Accounting for Investments in Subsidiaries	IAS 27 except for (d)	Consolidated Financial Statement and Accounting for Investments in Subsidiaries
19	Business Combination	IAS 22	Business Combination
20	Accounting for Investments in Associates	IAS 28 except for (e)	Accounting for Investments in Associates
21	Accounting for Leases	IAS 17	Leases
22	Interim Financial Reporting	IAS 34	Interim Financial Reporting
23	Accounting for Joint Ventures	IAS 31	Financial Reporting of Interest in Joint Ventures
24	Financial Reporting of Development- stage Enterprises	—	—
25	Segment Reporting	IAS 1 except for (f)	Segment Reporting
26	Agriculture	IAS 41	Agriculture
27	Retirement benefit plan	IAS 26	Accounting & Reporting by Retirement Benefit plan
28	General Insurance	IFRS 4	Insurance Contract
29	Real Estate	—	—
30	Earnings per share	IAS 33	Earnings per share
31	Non-current assets held for sale	IFRS 5	Non-current assets held for sale
Introductory matters		Preface	

Panel B: Iranian Auditing Standards Codification and Comparison with International Auditing Standards

Objectives and General Principle Governing Audit of Financial Statements	ISA 200
Terms of Audit Engagements	ISA 210
Quality Control for Audit Work	ISA 220
Documentation	ISA 230
Fraud and Error	ISA 240
Consideration of Laws and Regulations in an Audit of financial statements	ISA 250
Planning	ISA 300
Knowledge of Business	ISA 310
Audit Materiality	ISA 320
Risk Assessments and Internet Control	ISA 400
Audit Evidence	ISA 500

Table 2. (Continued)

Introductory matters	Preface
Initial Engagement- Opening Balances	ISA 510
Analytical Procedures	ISA 520
Audit Sampling	ISA 530
Audit of Accounting Estimates	ISA 540
Related Parties	ISA 550
Subsequent Events	ISA 560
Going Concern	ISA 570
Management Representations	ISA 580
Using the work of another auditor	ISA 600
Considering the work of internal auditing	ISA 610
Using the work of an expert	ISA 620
The auditor report on financial statements	ISA 700
The auditor's report on special purpose audit engagement	ISA 800
Engagements to review financial statements	ISA 910
Engagements to perform agreed-upon-procedures	ISA 920
Engagements to compile financial information	ISA 930
Particular considerations in the audit of small businesses	ISA 1005
Communications with management	ISA 1007

religious requirements, politics, and culture to globalization. The Iranian accounting profession is now facing many challenges and must effectively address the emerging challenges to stay relevant. Some of these challenges are: (i) moving toward adopting International Financial Reporting Standards (IFRS), (ii) computerizing accounting and auditing systems by implementing the extensible business reporting language (XBRL) and continuous auditing techniques, (iii) establishing an effective oversight function to monitor accounting practice and education similar to the Public Company Accounting Oversight Board (PCAOB) in the United States, (iv) implementing more vigorous and standardized certification procedures and licensing requirements, (v) moving toward integrated financial and internal control reporting, (vi) promoting business sustainability and accountability reporting that focuses on economic, governance, ethics, social responsibility, and environmental performance, (vii) developing a clear definition of the auditor responsibility in detecting irregularities, illegal acts, and fraud committed by clients, and (viii) promoting more relevant accounting education through redesigning the accounting curriculum in providing both technical and soft skills. Some of these challenges have been relatively addressed, but are still in their infancy.

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CHAPTER 3

ISRAEL

Yoram Eden and Dan Elnathan

INTRODUCTION

The State of Israel was established in 1948, but bookkeeping and accounting as means of record keeping and commercial communication have existed in this ancient land for centuries. A living laboratory for the environmental model of accounting, it has evolved over the years with economic changes and development, and shifting political influence, as well as other factors that have shaped the accounting system in Israel.

In this chapter, we will first discuss the factors that influenced and shaped the Israeli accounting environment for almost a century. We will then turn our attention to a systematic analysis and historical overview of the development of financial reporting standards in Israel, from the British laws of the 1920s to the fairly recent adoption of International Financial Reporting Standards (IFRS). Following that, we will describe the development of the profession and professional institutions.

INFLUENCES ON THE ISRAELI ACCOUNTING ENVIRONMENT¹

Radebaugh and Gray (2002) attribute the approach of environmental influences on accounting to Farmer and Richman's 1965 book, *International*

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Business, in which they provide an analysis of educational, sociocultural, legal, political and economic factors, and their impact on business and management practices. They argue that, "Like business in general, corporate accounting and information disclosure practices are influenced by a variety of economic, social, and political factors";² and present a model of environmental influences on accounting development.³ In this section, we will describe how some of the factors in their model apply to the Israeli accounting environment.

ECONOMIC FACTORS

Enterprise Ownership and Activities

In the prestate years of Israel, all large enterprises were created, owned, and controlled by the quasi-governmental Jewish institutions, mainly The Jewish Agency and the Histadrut (the labor union). Later on, during the early years of the State of Israel, the government remained the dominant player in the economy, as owner, employer, and regulator. Over the years, several large corporations that were owned by private (nongovernment) shareholders emerged, including some state corporations that were sold to private investors as part of the efforts of the government to privatize them. Also, many smaller companies issued shares to the public, and those shares are traded on the Tel Aviv Stock Exchange (TASE).

As Radebaugh and Gray note, the need for public accountability and disclosure increases when there is broader ownership of shares and greater separation of management from ownership. As Israeli companies transitioned to separation of ownership from management control, the need for stronger monitoring mechanisms increased and the accounting profession took part in those developments through direct action (setting directives) and participation in national and governmental regulatory bodies and professional committees.

Other important factors were the emergence of high-tech and pharmaceutical/biomed industries in Israel, and the significant number of Israeli companies that issued shares on NASDAQ and other U.S. exchanges.⁴ That has led to pressure on the investing community and the accounting professionals to understand and apply American reporting and auditing standards.

The Securities Markets

As capital markets develop and public corporations emerge, there is a need to establish a market in which their securities will be issued and traded.

Those markets have to be regulated in such a way that the information provided by the issuers of the traded securities will be accurate, reliable, and verifiable. The activity of the various parties acting in the Israeli capital market is regulated mainly by the following laws: the Securities Law (1968); the Companies Law (1999); the Joint Investment Trusts Law (1994); and the Investment Advice and Investment Portfolio Management Law (1995).

The Israel Securities Authority (ISA), the Finance Ministry (the Insurance and Savings Division), the Bank of Israel (the Supervisor of Banks), and the TASE regulate and monitor the entities operating in the securities market to ensure the integrity of the trading and the transparency to the investing public.

Local trade in securities began in the 1930s, years before the foundation of the State of Israel. Trade was carried out through the "Exchange Bureau for Securities," founded by the Anglo-Palestine Bank (which later became Bank Leumi Le-Israel) in 1935. With the declaration of independence of the State of Israel in 1948, the volumes grew and the need to formalize trade in securities was evident. In September 1953, a number of banks and brokerages joined forces and established the TASE. The TASE is a private company limited by guarantee. It is owned by its members, both banks and nonbanking corporations, through which anybody may trade in the securities listed on the exchange. Legally, the exchange is regulated by the Securities Law and falls under the direct supervision of ISA. Companies whose securities are listed on the TASE are subject to the directives set forth in the Securities Law and in its regulations, including those pertaining to financial reporting and other information disclosures. Those public companies are also subject to the directives set forth in the Companies Law, including directives related to their corporate governance, such as the obligation to appoint external directors, an audit committee, and an internal auditor.⁵

Level of Economic Development

At a low level of economic development, there is relatively little economic activity, and therefore, the need for elaborate financial reporting for external purposes (investors and taxation), or even for internal purposes, is limited. As the level of economic development increases, the demand for reporting standards and professional accounting services increases as well. Consequently, the supply of accounting and auditing standards, and accounting professionals also rises. Also, as the complexity of the country's

economy increases, new sectors and industries develop, with needs for new and relevant accounting standards and practices. For example, the emergence of the high-tech sector in Israel⁶ and, more recently, the pharmaceutical/biomed sector, created the need for the profession, the standard setters, and the capital markets to adjust and develop a better understanding of accounting for intangible assets and adopt a global perspective. The increased activity of corporate formation, global mergers and acquisitions, trading activity in various capital markets, and globalization of the local economy also put demands on the development of adequate reporting and auditing standards, and their adaptation to standards of other countries, as well as international accounting standards. A recent development that reflects the advanced level of the Israeli economy is the admittance of Israel into the Organisation for Economic Co-operation and Development (OECD) in 2010, which created the need to adopt OECD codes and norms.

A direct consequence of the global view taken by Israeli regulators, and the significant presence of Israeli companies on foreign markets, is the Dual Listing Law (2000). Under this law, the TASE allows companies that are traded on the NASDAQ, NYSE, AMEX, or the London Stock Exchange Main Market to dual-list their shares on the TASE without adjusting their financial reports to Israeli reporting standards. The companies are not even required to translate the financial reports to Hebrew, and they can be filed in their original format and language. The attraction of dual-listing is that it is easy to implement, does not impose any additional regulatory burden, and does not entail significant costs to the issuer. More than 35 companies dual-list on the TASE. Note that the dual-listing provision assumes that the local investing community either has, or can develop easily, working knowledge and understanding of the accounting and reporting standards of the stock markets in the United States and the United Kingdom, as well as the adequate command of the English language.⁷

The Orientation of the Economy

Radebaugh and Gray point out that reporting and auditing practices, orientation, and emphasis will differ between economies that are market-oriented and those that are planned, government-controlled. Such divergence in orientation will impact the orientation of reporting practices and emphasis. In the early years, the Israeli economy was government (or quasi-government) controlled, and the accounting, reporting, and auditing

practices did not emphasize the needs of private investors in public companies or the public companies themselves as they sought financing. As the economy moved gradually toward market orientation and adopted an Anglo-American approach, the accounting, reporting, and auditing standards and practices began to emphasize transparency and clarity, which are necessary for decision making by investors.

Another economic factor *that impacts Israel's accounting orientation* has to do with the fact that Israel is a small, open, export-oriented economy with significant foreign direct investment. In such circumstances, globalization is inescapable, and accounting harmonization in the form of adoption of International Accounting Standards (IAS), and later IFRS, was embraced relatively early as a way to improve access by investors to the local companies and capital market.

The Impact of Inflation⁸

A specific economic phenomenon that impacted Israeli accounting is the high level of inflation that persisted for decades. During periods of significant inflation, comparison of "nominal values" across time cannot be interpreted in a meaningful way, and the "historical cost" principal cannot be maintained. In such circumstances, the economic entity, and, in fact, the entire accounting system, must find a mechanism to adjust for the changes in the real value of the physical assets. The two common methods are general purchasing power (GPP) accounting and current value accounting (CVA).⁹

The Israeli economy experienced several prolonged periods of inflation since the early years of the state. The inflation intensified in the late 1970s, peaking at 445% annual rate during 1984. The first significant effort to deal with the effect of inflation on financial reports was in 1979, when the Institute of Certified Public Accountants in Israel (ICPAI) published Opinion 23, "Providing Information in Financial Reports on the Effect of Changes in the General Purchasing Power of the Israeli Currency on Companies' Profit and Loss," which applied to all publicly traded companies, and all other companies whose income met a set threshold level.

As the title of Opinion 23 indicates, the ICPAI chose to follow the GPP method, which maintains the historical values but adjusts them to the consumers' price index (CPI). Critics pointed out that while the opinion was a step in the right direction, it was an incomplete solution for the following reasons: (i) the disclosure was included in the notes to the financial statements and not in the financial statements proper; (ii) the requirement

was only for limited profit and loss information, and not for the entire profit and loss statement; and (iii) the requirement did not address the effect of inflation on the balance sheet. The opinion did allow, at the reporting entity's discretion, the possibility to provide a comprehensive adjustment of the financial statements.

Following Opinion 23, several amendments were adopted as more information became available and the accounting profession gained experience. The amendments included the application of the required reporting to all companies (Opinion 27, 1981); the requirement to include in the notes a summary balance sheet, adjusted for inflation, and details of the changes in equity, also adjusted for inflation, including prior year's comparisons, also adjusted for inflation (Opinion 34, 1984).

It should be noted that the tax authorities in Israel also addressed the issue of inflation and published the Income Tax Law (taxation under inflation), 1982, which was later replaced by the Income Tax Law (adjustment for inflation), 1985. Those laws employed a simplified GPP methodology to translate the nominal income to indexed-linked income. The income tax laws made a substantial contribution to the implementation and understanding the merits of the GPP accounting reported in Israel during the era of hyperinflation.

In March 1985, the ICPAI issued Opinion 36, "Guidelines for Preparation of Financial Statements Adjusted to the Changes in the Purchasing Power of the Israeli Currency," which represented a true revolution in financial reporting in Israel. Opinion 36 determined that rather than providing the inflation-adjusted information in the notes to the financial statements, all four major financial reports would be adjusted for the changes in general purchasing power. Also, the notes to the financial statements would include nominal values of the balance sheet and income statement, in summary form, as well as details of the adjustments that were necessary in order to provide the inflation-adjusted balances. Still, the income statement did not include a comprehensive adjustment to inflation under Opinion 36, and the requirement was added later on, in Opinion 50 (1989).

When inflation levels in Israel decreased significantly, the Israeli Accounting Standards Board issued Standard 12 (2001), which eliminated the inflation adjustment of financial reports, starting in 2004.¹⁰ The decision to cease the inflation reporting caused a tense debate, and many firms argued that inflation adjustment is preferable to nominal reporting even in periods of relatively low inflation rates. This dispute has been brought before the Supreme Court of Israel. However, the Court has reinforced the authority of the Israel Accounting Standards Board to

publish accounting standards (including standards about termination of the inflation adjustment).

The experience that Israeli accountants gained in inflation accounting and related issues was instrumental in the development of IAS 15, and later IAS 29, where representatives of the ICPAI participated in the development of that IAS.

ACCOUNTING PROFESSION AND ACCOUNTING EDUCATION

The level of education in the general population, and accounting education specifically, has significant implications for the sophistication of the country's accounting system. The higher the level of literacy in the country and the greater the number of trained accountants, the more equipped the profession is to deal with complex financial reporting problems and needs. These national characteristics will have a direct impact on the ability of the profession to recruit and train individuals who can develop and implement accounting and auditing standards, and on the ability of users – managers, investors, and the general public – to understand and use financial reports effectively.

The literacy level in Israel, according to the *CIA World Factbook* (2011), is 97.1%.¹¹ That level ensures adequate ability of the workforce to develop and operate complex accounting systems. The number of certified accountants in Israel is approaching 16,000 (2010), or 2.1 per thousand. That number places Israel between the United Kingdom and Canada, with approximately 3.5 accounting professionals per thousand, and the United States, with 1.68 accounting professionals per thousand.¹²

POLITICAL FACTORS

During the days of the Ottoman Empire, accounting in the region was influenced by the Turkish rulers. Historical records show that when the "Anglo-Palestine Bank" was established in 1902, an accounting guide was written to educate employees in the Ottoman rules. Following World War I, when the British Empire received mandate over Palestine from the League of Nations, British law dominated and the commercial standards of the British Empire were put in place, although some Ottoman rules and forms of commercial entities were allowed to continue in existence.

That influence continued after the independence of the State of Israel in 1948, but over the years, the United States' political and commercial influence increased, and consequently the accounting approach and thought has tilted toward the American school of thought. For example, the Securities Law (1968) was written with the U.S. securities laws as a model. It should be noted, however, that although the American political influence on Israeli life continues, the Israeli regulators and standard setters chose to adopt IAS, and IFRS, and part ways with the American system, which is slow to make that change. That move can be attributed to the economic considerations that were reported previously, and the increased importance of Europe and other countries as trade and business partners of Israeli companies.

LEGAL FACTORS

The legal system that exists in a country is also relevant to the accounting system in that country. Accounting systems in "code law" (or civil law) countries tend to be more detailed and cumbersome, relative to accounting systems in "common law" countries, which are more flexible and allow for professional judgment. Still, in instances where the legal system is impacted by what one can call "legal culture," such as the litigious nature of the U.S. system, the accounting system will also be influenced by the profession's need to protect itself against litigation. As a result, the accounting standards become complex although it operates in a "common law" country.

The tax legislation can have significant influence on accounting and auditing standard setting and practice, in particular when the tax accounting relies primarily on financial reporting (Japan, Germany), as opposed to countries where financial reporting to investors differs significantly from tax reporting (United States, United Kingdom).

Israel is a "common law" country with a long Anglo-American tradition. The Companies Act (1929) was enacted by the British, who ruled Palestine at the time, simultaneously with its introduction in Britain. That law remained in effect for 70 years, until it was replaced by the Companies Law in 1999.¹³ Over the years, the influence of the American legal system became more prevalent, and as we mentioned earlier, the Securities Law (1968) is following the American securities laws, and that influence is explicitly mentioned in ISA's discussion of the law. Similarly, the Israeli tax code and tax accounting are following the Anglo-American approach, rather than the European approach.

CULTURAL FACTORS

The impact of culture on national accounting systems has been discussed in the literature for three decades, to a large extent stemming from Hofstede (1980). However, since "culture" is not well defined, its impact is also not well defined. In Hofstede's original study, Israel was grouped with Austria, Germany, and Switzerland in the Germanic "cultural area." An effort by Gray (1988) to map accounting systems according to "accounting value dimensions," did not explicitly consider Israel but would have placed it in the Anglo group in all dimensions. That association was more recently validated by Doupnik and Salter (1995), who place Israel's accounting system with those of Bermuda, Canada, and the United States. It is probably the case that over the years the culture in Israel shifted from being influenced by British and European culture to a more significant influence of American culture. It is evident in a more individualistic approach, and stronger expectations for monetary rewards and personal satisfaction, as opposed to the collectivist nature of the society in Israel during the early years of the state. A recent evidence of this shift is the dismantling of an Israeli icon, the Kibbutz. More than 250 of those collective communities were created since 1910, but over 75% of them have given up their collectivist ideals and adopted a more individualistic approach over the past 10 years.

FINANCIAL REPORTING REQUIREMENTS IN ISRAEL¹⁴

The law in Israel requires that all companies prepare financial statements in accordance with generally accepted accounting principles (GAAP). Still, public companies are required to report information that is significantly greater than private companies, and directors and officers of public companies bear much greater responsibility than those of private companies.¹⁵ For example, public companies are required to provide quarterly financial statements. Also, the Securities Law requires that publicly traded companies, or companies whose securities have been offered to the public through a prospectus, must publish information that is deemed important for their investors or potential investors. Such requirements apply both at the initial public offering stage as well as periodically as long as the securities are traded or outstanding.

Furthermore, the most significant difference between financial reporting of public and private companies in Israel is the basic fact that the former

is available to all interested parties. This stems from the obvious – the sale of securities is different from any other sales transaction. Unlike other assets, securities are assets whose real value is not known to the investing public, while the managers and insiders of the corporation have access to information that helps them to better estimate the real value of the securities. This asymmetry of information gives rise to full disclosure requirements, rather than a “buyers beware” approach.

A private company is required by the Companies Law to keep records and prepare, for each calendar year, financial statements that include balance sheet, statement of profit and loss, and other financial reports according to GAAP. The law also requires that the reports be audited by a certified auditor. The reports have to be submitted to the Companies’ Registrar within six months of the end of the fiscal year, or any other period as determined in the company’s bylaws, as long as that period does not exceed nine months.

A public company is required by the Companies Law to keep records and prepare financial statements according to the requirements in the Securities Law. That law requires that public companies prepare and submit to the ISA, the Companies’ Registrar, and TASE the following reports in the normal course of business:

- a. Periodic report that has to be prepared annually within three months of the end of the fiscal year and includes four parts: (i) description of the business of the company; (ii) report of the board of directors; (iii) annual financial reports;¹⁶ and (iv) other information.
- b. Interim financial statements and board of directors’ reports are prepared in summary form for each of the first three quarters of the fiscal year and have to be provided within two months after the end of the period.
- c. Immediate reports that describe certain events such as changes in issued equity, changes in holdings of insiders, insider transactions, and changes in directors, officers, and auditors.

It is clear that the disclosure requirements of public companies are not limited to financial statements and include additional information.

SETTING FINANCIAL REPORTING STANDARDS IN ISRAEL

The institutions that are charged with setting accounting standards in Israel have changed over the years, following a process that is similar to

the American and British models, among others. Although at first, the professional accounting organization – the ICPAI – was also in charge of setting accounting and auditing standards, later on an independent board was established to carry out the accounting standards setting, while the professional organization was left with the task of setting auditing standards and guidelines.

Pre-Statehood Era, 1931–1948¹⁷

The ICPAI was formed in 1931, 17 years before the independence of the State of Israel, as The Society of Certified Accountants and Auditors under the Ottoman Law of Societies. The Certified Public Accountant's (CPA's) work was based on the British Companies Act, which required every company to appoint a CPA to prepare its annual reports, and the GAAP was based on British GAAP.

In 1941, the British Mandate government published the first Income Tax Ordinance, and that act increased the responsibility of the CPA. While creating increased opportunities, the new law created increased competition, and that forced the membership and the board of the society to address new challenges. Several committees were created by the society, including professional committee, disciplinary committee, and appeals committee. The bylaws of the society were revised, and several additional codes were written, including "The work of the CPA" code and "Professional Ethics" code. The society also deliberated and published guidelines for the practice of tax reporting. As the Jewish quasi-governmental institutions became more active and established economic committees, the society of CPAs was asked to appoint members who participated in those committees.

The Role of the Institute in Setting Standards, 1948–1997

Already in 1947, the British Mandate government had weakened and the revenue tax offices did not function. Concurrently, the Jewish institutions that operated in Palestine continued to assume quasi-government roles. In April 1948, one month before the official declaration of the State of Israel, an alternative tax collection system was created, and the society of CPAs was asked to assist in the matter.

In July 1948, two months after the declaration of independence, "The Society of Certified Accountants and Auditors in Israel" was recognized by

the Israeli government as the sole body that would represent the accounting profession.

One of the primary objectives of the society was the publication of financial reporting standards and auditing guidelines. In 1950, the society published sample financial statements and auditor's letter, and although the society's publications did not have an official legal status, the fact that they were published by the only recognized professional accounting organization, and that most Israeli CPAs were members of that organization and bound by its professional code, established them as *de facto* Israeli GAAP. An addendum in 1973 to the Accountants Law (1955), concerning the professional conduct of the auditors, determined that an auditor who acted according to the Institute's standards was deemed to act according to generally accepted auditing standards.

During the 1960s, the ICPAI established a professional council and two committees – one that was charged with publishing accounting "Opinions" and providing professional interpretations to financial reporting issues, and one that was charged with setting auditing "Standards." The ICPAI published 69 opinions between 1948 and 1997, when the standard setting responsibility was passed to the Israel Accounting Standards Board (IsASB). The ICPAI continues to publish auditing standards and has published 104 to date.

ISRAEL ACCOUNTING STANDARDS BOARD

Following the recommendations of a public committee that studied the Israeli capital market, and similar to a process that occurred in the United States more than two decades earlier, the authority to set financial reporting standards in Israel was transferred in 1997 from the Financial Accounting Standards Committee of the ICPAI to an independent board, the IsASB. The Board's stated objectives are to enhance the level of accounting in Israel and to improve the quality, transparency, and reliability of the information that is included in financial reports. Accounting standards setting includes promulgation of new accounting and disclosure standards and guidelines, revision, correction, and elimination of existing standards and clarifications. All these are considered generally accepted accounting standards in Israel.

The Board is sponsored jointly by the ISA and the ICPAI, and consists of two operating bodies. It is important to note the makeup of the two bodies, and the delicate balance between regulators, the profession, and the economic organizations that are subject to the standards. The main organ is a

seven-member professional committee, where the chairman's position is a full-time paid position, while the other six members are without pay. The chairman of the Board is appointed by agreement between the ISA and the ICPAI, after consultation with the chairman of the Israel Accountants' Council (a position that is held, by law, by the Director General of the Ministry of Justice). The chairman cannot engage in any other activity (except research and teaching). The first two chairmen came from academia, and the third came from practice. The other members are nominated by the founding bodies – three members are appointed by the ISA and three are appointed by the ICPAI. Seven additional permanent participants, who are also agreed upon by the founding bodies, are invited to attend the Board's meetings on a regular basis, but without voting rights. Additionally, the chairman may invite to specific meetings participants with expertise in the relevant topics.

The IsASB is monitored by a council that consists of 17 members. The chairman of the council is appointed by agreement between ISA and ICPAI, after consultation with the chairman of the Israel Accountants' Council. The chairman of the ISA and the president of the ICPAI serve as vice chairman, and the other members are nominated as follows: Five are nominated by the ICPAI, three by the ISA, and the rest include the banks supervisor, the insurance supervisor, the head of the Tax Authority, the chairman of the TASE, a representative of the Council of Economic Organizations in Israel, and a representative of the association of Public Companies in Israel. This diverse representation ensures independence and objectivity of the Council and the Board, as well as sensitivity and responsiveness to the demands and needs of the various users of financial statements. The idea of representation by and responsibility toward the public is also apparent in the way the Board operates. The minutes of the board's discussions are open to public review, and the standard setting process includes public hearings and opportunity for public comments and involvement. The Council's main role is to provide advice to the professional committee as to its agenda and priorities, but it has two other significant functions – approval of the budget and the power to delay adoption of a standard.

Additionally, the Board employs permanent professional staff that prepares material and conducts necessary research. The staff reports to the professional committee. The Board may also hire experts that are not on the permanent staff if the chairman deems it necessary.

It should be noted that unlike the FASB in the United States, the members of the Board in Israel are not paid, and may continue to work in practice, including as auditors and CFOs. This fact has not escaped critics

who claim that under such conditions there is danger of conflicts of interest. Also, the IsASB budget is miniscule, in comparison to the FASB.

The IsASB published 32 standards between 1998 and 2010, as well as a conceptual framework (2005), guidelines, and interpretations.

Adoption of IAS and IFRS

The IsASB began to adopt IAS in 2001, in a piecemeal fashion. During the period 2001–2006, the IsASB published over 20 standards that were based in the most part on IAS with some changes (see section “The Standard Setting Process at IsASB (Prior to IFRS Adoption)”). In November 2005, the professional committee of the Board decided on a comprehensive and sweeping adoption of international standards. In July 2006, Standard 29, “Adoption of International Financial Reporting Standards” was published and states that all public companies in Israel will have to publish financial reports for the periods after January 1, 2008, according to IFRS. The fact that the reports are based on IFRS will be explicitly disclosed in Note 2, “The basis for the preparation of the financial reports” and in the Auditor’s Opinion letter. As of that date, all standards that were promulgated by the Board and by the ICPAI prior to that shall no longer apply to public companies. All international standards were translated to Hebrew, and the translation was approved by an experts’ committee. The Hebrew version of the standards is deemed to be the authoritative standard in Israel.

The comprehensive framework that was developed by the International Accounting Standards Board (IASB), which issued its “Framework for the Preparation and Presentation of Financial Statements” in 1989, was adopted in Israel in 2005.

As for nonpublic entities, they are not required to switch to IFRS, and the standards that were published by the IsASB and those that were published previously by the ICPAI and endorsed by the IsASB still apply.

The Standard Setting Process at IsASB (Prior to IFRS Adoption)

While currently the adoption of IFRS is automatic, it is instructive to review briefly the standard setting process until 2007. The process of standard setting began typically with an ad hoc team, whose members may not be Board members but who had an interest and knowledge in the topic that was being considered. The team was responsible for the translation of the relevant international standard and for comparison with the situation and relevant standard(s) in Israel, as well as reference to other sources, and in

particular to U.S. GAAP. At the end of this phase, the team presented to the Board a document that included discussion and recommendations. After deliberations, the Board published a proposal for a standard that had to be approved by at least five of its seven members. It was then submitted to the ISA and the ICPAI for comments, which were to be submitted within six weeks. The Board then took into consideration the comments and revised the proposal, which was then made available to the public who was asked to submit comments within three months. Also, during this period, a public hearing was held, and the public was invited to make their comments in person. At the end of this phase, the Board deliberated again, taking into consideration the public's comments, and revised the standard accordingly. The final standard was then approved by the Board with a vote that had to be at least 5-2, and was resubmitted to the ISA and ICPAI for a period of 30 days, at the end of which the standard was deemed in effect.

It should be noted that both the ISA and the ICPAI had the power to delay the publication of a standard for a period of three months, and the 17-member council of the IASB had the right to prevent a standard from becoming effective with a vote of at least 13-4.

THE ISRAEL SECURITIES AUTHORITY¹⁸

At this point, we turn our attention to the ISA, which is a key player in the financial reporting arena in Israel. As the previous discussion indicated, the ISA is the organ that oversees financial disclosure and Israeli GAAP, and it is very active in fulfilling its duties. The ISA drafts and initiates virtually all primary and secondary legislation pertaining to securities laws in Israel, which are then presented to the *Knesset* (Parliament) for formal legislation. The ISA collaborates with the ICPAI, in operating and financing the Israel Accounting Standards Board, which is charged with setting accounting standards for Israeli companies.

The ISA was established under the Securities Law (1968) and its mandate is to protect the interests of the investing public by ensuring the existence of an efficient capital market that is based upon adequate disclosure, fairness, and equality among investors. The ISA is charged with handling, inter alia, issues such as public securities offerings; examination of corporate filings, including quarterly and annual periodic financial statements; overseeing the fair, orderly, and efficient conduct of secondary markets; and investigating violations under the Securities Law and other related laws concerning securities and funds, including "convenient" explanations for accounting rules for purposes of presenting financial results that are more appropriate

for corporate goals than for presenting a true picture of affairs ("profit management").

In practice, the Securities Law follows the principles set out in the American securities laws. The ISA operates under the convention that a crucial condition for attracting both domestic and foreign investors and issuers to the capital market, which is central to the economy's development, is the existence of maximum transparency and fairness. This transparency is first reflected in the promise of disclosure to the investing public of all material information that is required to make an intelligent investment decision.

In the past decade, the ISA has been active in initiating changes and revisions to the securities laws. One such initiative led to the creation of the IsASB, and expansion of disclosure requirements so that they include, in addition to annual reports, surveyed summary quarterly reports. Due to its regulatory power, the ISA support was critical in the IFRS adoption. And in January 2008, simultaneously with the introduction of IFRS, it introduced the Extensible Business Reporting Language (XBRL), an electronic language used for reporting of financial and other data, whose worldwide use had accelerated lately. The ISA stated that

The application of XBRL to the computerized system of the ISA is becoming more relevant than ever, in light of the IFRS adoption (which started in January 2008). This increases the use of XBRL, since it makes the data of the Israeli reporting entities both accessible and clear to investors all over the world without them being able to read Hebrew.^{19,20}

That push toward globalization was also central to the decision to adopt the Dual Listing Law that was discussed earlier, in which the ISA relinquished its regulatory power and accepted the reporting standards in the United States for companies that are traded on American stock markets and wish to dual-list on TASE. This amendment to the Securities Law was based on the belief that the American reporting system is the most developed in the world, and the fact that these corporations are already regulated by the American securities authority (Securities Exchange Commission (SEC)).

Other significant efforts that are intended to enhance the integrity and usability of financial reporting include revision to the directors' report on the state of the corporation affairs, regulations regarding financial reports of consolidated companies, and a recent call to the public to propose ways to simplify financial reporting and disclosures. Also, the newly appointed chairman of the IAS declared recently that he would initiate an Israeli body that will be similar to the Public Company Accounting Oversight Board (PCAOB).

GOVERNMENT ACCOUNTING STANDARDS IN ISRAEL²¹

Following in the footsteps of several leading Western countries that initiated reforms in government accounting, the government of Israel decided in August 2004 to gradually adopt the International Public Sector Accounting Standards (IPSAS) and implement them in all government offices and noncommercial statutory corporations. The government also decided to create the Israel Government Accounting Standards Board (IGASB) to facilitate the transition to international public sector accounting standards.

As a result, the government of Israel has implemented a major reform in government accounting, focusing on gradual adoption of IPSAS, accounting controls on all state's assets and liabilities, and gradual transition from the cash basis to accrual basis of reporting. Additional steps that are intended to increase the reliability of government financial reporting include independent external audits of the financial statements. The explicit purpose of this reform is to provide the general public, decision makers, and other users of the financial reports, with comprehensive and reliable information on the financial position of the government of Israel, based on the belief that transparency is a cornerstone of proper and efficient administration.

The IGASB engages in setting government accounting standards in an effort to improve the financial reporting of government offices and entities. The Board's professional committee is providing accounting standards that are essential in order to ensure an efficient and effective democratic government system. The standards are designed to assist decision makers in implementing economic and social decisions and provide them with comprehensive and relevant information to carry out their duties. By using this information, elected and appointed officials in the parliament and government can better engage in short- and long-term planning, monitor progress of national economic and social projects, and evaluate performance of individual government offices and the government as a whole. Additionally, these reports give the citizens a tool through which they can follow how the public funds are being used, and evaluate the impact of the government's decisions on the current and future financial position of the state.

The professional committee's work is often based on the work of the International Public Sector Accounting Standards Board (IPSASB), adapted on occasion to specific needs that are unique to the Israeli environment. Still, because of the close resemblance to the IPSAS, the financial statements of the government afford transparency and comparability across periods and with

other countries, and thus offer a true assessment of the country's financial position. As a result, the financial activities of the government of Israel are reliably disclosed and provide more precise and reliable economic data that makes it possible for the government to issue bonds and receive grants, loans and guarantees.

AUDITING STANDARDS IN ISRAEL²²

We briefly described above the work of the professional committees of the ICPAI. It should be noted that while the IsASB has ceased to work independently on setting financial reporting standards, the ICPAI's committee on auditing standards continues to operate and publish auditing standards, regulations, and guidelines, albeit with reference to the International Auditing Standards (ISAs).

In March 2009, the International Auditing and Assurance Standards Board (IAASB) announced that it completed its Clarity Project in which all ISAs were revised and presented in a new format. The project produced a new set of 36 ISAs and an International Standard of Quality Control (ISQC), which were improved, clear, and user-friendly. The standards apply to all audits starting in FY 2010.

As early as 2000, the ICPAI decided to publish new auditing standards that would replace the existing ones and be based on the ISAs. True to that purpose, 20 auditing standards were published in Israel during the period 2001–2004, most of them translations of the ISAs that were in effect at the time. That push significantly reduced the gap between the auditing standards in Israel and the international standards, although some gaps remain. Among them, critics mention the weakness of Auditing Standard 73, the Israeli counterpart of the comprehensive ISA 200, concerning "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing." Furthermore, the important issue of audit risks, which is included in ISA 200, is not covered under the prevalent Israeli standard. Another weakness that is pointed out is in Auditing Standard 9, concerning "Reliance on other Auditors in Audits of Group Financial Statements," which is 37 years old and reflects a gap in practice between Israel and the rest of the world, which uses ISA 600.

According to the critics, the Israeli standards are long, cumbersome, and poorly phrased, while the international standards are much clearer. Additionally, certain topics that are covered in the ISAs are not yet addressed in the Israeli Regulation, such as ISA 220 (Quality Control for an Audit of Financial Statements); ISA 250 (Consideration of Laws and

Regulations in an Audit of Financial Statements); ISA 265 (Communicating Deficiencies in Internal Control to Those Charged with Governance and Management); and ISA 450 (Evaluation of Misstatements Identified during the Audit).

THE PROFESSION AND PROFESSIONAL ORGANIZATIONS

The profession in Israel is operating under several laws that regulate its activities, such as the Accountants Law (1955) and the regulations that accompany it, including "Behavior that does not befit the Profession" (1965), "The Activities of The Accountant" (1973), and "Conflicts of Interest and the Effect of Engaging in Other Activities on Auditor's Independence" (2008). Additionally, auditors are required to follow guidelines that are included in the Securities Law (1968), the Companies Law (1999), as well as additional laws that govern economic entities, such as partnerships, investment funds, banks, and insurance, among others.

The authority to supervise the accounting profession in Israel is delegated by the Accountants Law to the "Israel Accountants' Council."²³ The council is a statutory body with 14 members, which is subordinated to the Ministry of Justice and headed by the Director General of the Ministry of Justice. The law and associated regulations detail the matters that the council oversees, including professional exams, licensing, monitoring of apprenticeship terms and conditions, addressing complaints regarding behavior of accountants that does not befit the profession, and continuous supervision of the profession in Israel.

The council consults with professional and regulatory bodies around the world, among them the American Institute of Certified Public Accountants (AICPA), FASB, the Government Accounting Standards Board (GASB), IASB, the International Federation of Accountants (IFAC), and the International Organization of Securities' Commissions (IOSCO).

The Enron Crisis and the SOX Act Implications

The profession in Israel did not escape from regulatory critical examination stemming from the Enron scandal and the SOX Act. This examination led to three major actions:

- a. New bylaws on "Conflicts of Interest and the Effect of Engaging in Other Activities on Auditor's Independence" (2003).²⁴ These bylaws adopted

the IFAC Code of Ethics with some adjustments (particularly to the audit of closely held companies).

- b. The establishment of a Peer Review Institute.
- c. Adoption of a modified version of SOX regulation, which is called Israeli Sox or ISOX (starting from the FY 2010).

The Peer Review Institute is a new and innovative model in the Israeli accounting. It began operations in January 2005, and by mid-2006 had certified over 100 experienced CPAs, who are charged with review of their peers in the accounting firms that audit public companies. As part of the review, the examiner checks audit procedures, quality controls, ethics and independence issues, confidentiality and information security, and more. The findings are shared with the ISA.

During the early years of the Peer Review Institute, leaders of the profession believed that it would eliminate the need to create an additional supervision institute (like the PCAOB). However, this is now being reconsidered by the ISA.

*Education and Certification*²⁵

In order to become a licensed CPA in Israel, candidates must complete four years of academic studies, which exempt them from most of the required exams, and pass two final exams. A candidate that does not go through the "academic" track must pass 15 exams²⁶ (the "external" track). While in the early years of the profession in Israel the external track dominated, since the 1990s, the academic track is the dominant track and approximately 90% of all new CPAs are licensed through that track. Two contributing factors are credited with this change. One is the increased importance of an academic degree for one's career, and the other is the insistence of the large- and medium-sized accounting firms to recruit only candidates with academic degrees. As a result, the number of academic institutions offering accounting degrees in Israel has grown from 2 in 1975 to 24 in 2010, and the number of students entering those programs has grown from a couple hundred students to several thousand (annually) during the same period.

All candidates, regardless of track, must also complete two years of apprenticeship of no less than 35 hours a week under the supervision of a qualified licensed accountant. A certified public accountant can qualify as a supervisor if she or he has been a licensed accountant in good standing for at least five years and has been engaged in audit work for at least three years.

Accounting Firms in Israel

All major international accounting firms and networks are represented in Israel. While some affiliations have existed for many years, during the 1990s, Israeli affiliates became full members of the big international firms. There are approximately 2,000 accounting firms in Israel, but most of them are firms with a small number of partners. The concentration in the profession is evident when one considers the fact that over 85% of public firms are audited by the top six accounting firms in the country, which are all related to the Big 6 international firms.

*The Institute of Certified Public Accountants in Israel*²⁷

The Institute of Certified Public Accountants in Israel (the Institute) is a voluntary body of licensed accountants that was established in 1931, 17 years before the establishment of the State of Israel, as "The Society of Certified Accountants and Auditors" under the Ottoman Law of Societies. By the end of 1931, the membership stood at 7, and by the end of 1939, there were 18 individual members, both Jewish and Arab. There were also two British accounting firms that operated in what was then Palestine, but they did not cooperate with the local society. The economic activity in Palestine was slow until 1933, the number of companies that required the services of the profession was small, and the profession developed very slowly. Additionally, the British accounting firms captured a significant market share, even among Jewish businesses, because they had better connections with the British Mandate government.

After 1933, the Jewish immigration from Germany increased and, with the inflow of capital, the pace of economic development picked up. As a result, the number of companies increased from year to year, and several Jewish accounting firms emerged and established themselves. Most of the society's activities during its first decade of operations were directed toward securing acceptance of the society and its members by the British Mandate government and its various organs – the courts, the companies' registrar, and the tax officers – as well as by the local business community. Salary ranks for firms' employees were determined, and a recommended rate scale for the work of a CPA was published. In 1941, the society hired its first salaried employee, a technical secretary, who worked on a part-time basis.

World War II brought new threats to the country and the profession, as it did around the world. Imports shrunk, yet economic activity grew due to the increased demand of the British army, which had a large force in Palestine. Price inflation forced the issue of salary increases to firms' employees, and by 1943, an agreement was reached between the society and the labor union regarding pay scales and work conditions of employees of accounting firms. A significant effort was directed toward the protection of the professional status of the certified accountant, and the society asked the government to create a specific law that would address the matters of the profession. Also, as the Jewish quasi-governmental institutions became more active and established economic committees, the society was asked to appoint members who participated in those committees.

Following the declaration of independence and the creation of the State of Israel, immigration increased and development was evident in all aspects of the economy, including the accounting profession. Membership increased from 43 in May 1948 to 60 by year-end 1949, and in July 1948, "The Society of Certified Accountants and Auditors in Israel" was recognized by the Israeli government as the sole body that would represent the accounting profession.

With the departure of the British from Israel, the professional examinations that were conducted by the British institutions also ended, and there was a need for new institutions to address professional certification matters. The society approached the Minister of Justice and, in February 1949, a certification committee consisting of three government representatives and two representatives of the society was appointed. The committee certified 25 new CPAs who had taken their examinations abroad, or before May 1948, and in its first meeting in 1949 the committee decided to establish a complete and independent examination system. The preparations for the new examinations took over a year, and the first examination session was in May 1950 when 35 candidates took all or some of the exams. The committee reported to the Minister of Justice in June 1950 that "the exams were carried out in perfect order, and we await their results shortly."²⁸

During the period 2005–2010, over 3,000 newly minted CPAs were licensed, but not all licensed CPAs joined the Institute. As of 2010, it is estimated that over 12,000 Israeli CPAs are members of the Institute, out of a total population of CPAs that approaches 16,000. The Institute also has 130 international adjunct members.

The Institute has various stated goals and functions: serving its members and developing the profession in Israel; the advancement of the accounting profession; participation in the development and setting of high-quality professional accounting standards; the development and setting of high-quality professional auditing standards; the issuing and enforcing of ethical rules; and the strengthening of public confidence in the profession.

The Institute is involved in certain areas of the fiscal lawmaking process in the Knesset and also acts as an advisor to the bodies supervising government-controlled companies, insurance companies, banks, and other institutions on issues of professional standards and related matters. It is the only professional association that is engaged in setting the norms and standards of its profession and has published to date over 150 financial reporting and auditing standards. In 1997, the Institute joined with the ISA and founded the IsASB, which is the authority charged with setting financial reporting standards in Israel.

The ICPAI has professional committees for financial reporting and auditing standards; a consulting council; a judicial system that deals with complaints from the public and from members regarding the integrity of the members and violations of the law, regulations, or guidelines; an interpretation committee that issues opinions; and over 200 professional and administrative committees dealing with a wide array of matters. This work is done by over 1,400 volunteer members, or well over 10% of the entire membership of the Institute.

The Institute provides continuing professional education and publishes diverse and extensive professional material, including three professional journals: *Taxes*, which presents all issues regarding taxes and taxation in Israel; *The Accountant*, which presents current events, essential information, and updates regarding the profession in Israel; and *Taking into Account*, published monthly by the Institute that covers contemporary social and economic topics.

The ICPAI is an active member in the International Federation of Accountants (IFAC). It is also a member of the *Fédération des Experts Comptables Européens* (FEE), and the *Fédération des Experts Comptables Méditerranéens* (FCM). Additionally, the Institute is affiliated with most international accounting and auditing associations and participates in many of their meetings and conferences.

In addition to its involvement in advancing the profession and strengthening its activities, the Institute established an Awards and Scholarship Committee. The Committee gives scholarships, awards, and financial assistance to needy students based on academic merit, as well as assistance to immigrants who hold a CPA license.

CONCLUDING REMARKS

The development of financial reporting in Israel and the changes in its accounting environment in the last century reflect the changes in the country's political, legal, and economic environment. From a small, mainly agrarian economy emerged a robust, world-class, developed economy, with significant global presence in industries such as high-tech, pharmaceutical, and biomedical.

The accounting environment – the institutions, the profession, and the standards – has kept pace and adapted to the changes, eventually adopting IFRS in order to allow all players in the local financial markets to benefit from globalization. That process made it possible for Israeli investors to play a part in international investments, and for foreign investors to partake in the Israeli economy through the local and international capital markets.

Innovation and adaptation are deeply rooted traits of the Israeli national character and indeed can be described as cultural characteristics. Given those, one can expect that in the future, as the economic environment continues to change, the accounting environment will change with it.

NOTES

1. The discussion of environmental influences on accounting draws on Radebaugh and Gray (2002, Chap. 2).

2. *Ibid.*, p. 20.

3. *Ibid.*, p. 21, Fig. 2.1.

4. For many years, Israeli companies were the largest group of non-U.S. issuers on U.S. markets. In 2010, they dropped to second place, behind Chinese companies.

5. For further information on TASE, see <http://www.tase.co.il/TASEEng/homepage.htm>. Accessed January 30, 2012.

6. See, e.g., Senor and Singer (2009).

7. Although all companies are required to use XBRL (see below), one may argue that the language barrier is less significant.

8. This section draws on discussion in Unit 11 of Aharony (1999).

9. See, e.g., Radebaugh and Gray (2002, pp. 289–304).

10. The adjusted reporting for income tax purposes ceased only from the FY 2008.

11. Retrieved from <https://www.cia.gov/library/publications/the-world-factbook/geos/is.html>. Accessed on January 30, 2012.

12. Radebaugh and Gray (2002, p. 317).

13. Gross (2007) notes that the Companies Law (1999) has made an effort to codify existing law and common law, but that does not mean that the Israeli legal approach has become the “code law”.

14. This section draws on Shuv (2007).
15. A public company is defined by the Companies Law as a company with more than 50 shareholders and a private company as a company with less than 50 shareholders.
16. Consolidated financial reports prepared according to IFRS, and separate reports of the company, prepared according to the ISA bylaws.
17. This section draws on Levin (2011).
18. This section draws on material from the ISA webpage. Retrieved from <http://www.isa.gov.il/Default.aspx?Site=ENGLISH>. Accessed on January 30, 2012.
19. Statement on the ISA webpage. Retrieved from <http://www.isa.gov.il/Default.aspx?Site=ENGLISH&ID=2868>. Accessed on January 30, 2012.
20. To date, analysts have not used the XBRL data as much as the ISA expected them to.
21. This section draws on the official website of the Accountant General in the Ministry of Finance, Government of Israel (in Hebrew), and the 2010 Financial Statements of the Government of Israel (in English).
22. This section draws on Ben Altabet (2010).
23. The council is the only entity that is allowed to issue the "Certified Public Accountant" License, and only licensed accountants can carry out certain duties according to that law, as well as other companies' laws and regulations.
24. These bylaws were revised in 2008.
25. The information was compiled from several sources, primarily from ICPAI's website. Retrieved from <http://www.icpas.org.il/english/>. Accessed on January 30, 2012.
26. The exams include topics such as financial accounting, managerial accounting, auditing, and taxation, as well as law, economics, statistics, information technologies, and finance.
27. This section draws on Levin (2011).
28. Letter from the Society of Certified Accountants and Auditors in Israel to the Minister of Justice, June 1950.

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CHAPTER 4

RUSSIA

Mikhail I. Kuter and Vyacheslav Y. Sokolov

INTRODUCTION

Accounting in Russia has always developed under the influence of Western ideas, which did not prevent it from keeping its originality. The distinctive nature of the Russian accounting system is primarily due to the predominantly state-owned character of the national economy. Even in the period of the nascent market economy (beginning with the reforms of Alexander II in 1861 until the Revolution of 1917, and in the post-communist period starting from 1991) the state sector was always dominant, overwhelming the private sector. Throughout the entire Russian history, accounting was based on virtually the same principles.

The first principle is that of the supremacy of the state property: the state is an owner of all or nearly all the property in the country. This principle dictates the need for a single body establishing the rules of keeping accounting records and the organization of accounting. This principle emerged in the households of ruling princes at the dawn of the Russian state in 862, along with the spread of the Varangian accounting methods.

The second principle is that of financial liability. Accounting is personal in nature and is primarily focused, rather than on property items, on persons enjoying the rights of administration of such items, who are under the obligation to compensate the owner, i.e., normally, the state, for any shortfall of such items. This principle originated in monastic households

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under the influence of Byzantine accounting concepts. The personal liability for the integrity of property of others (whether governmental, public, or private) constituted the basis of the accounting system, turning the controlling function of the accounting system into the dominant one. Later, the Tartar-Mongol yoke consolidated this principle through the introduction of a special kind of tax, the poll tax, which was subsequently replaced by taxation based on the number of ploughs, with simultaneous introduction of the frank pledge principle, i.e., the principle of collective responsibility of a community for all the debts of its members.

The third principle is that of the task-work, or fixed task: each laborer is to be given a fixed task, specifically, how much work, of what particular nature, and in what timeframe he or she is required to perform. This principle, combined with the dominance of state financing as a basis for investments in the economy, led to a requirement to keep record of the implementation of the task (budget), bringing closer the financial and in-office accounting; very common forms of accounting were the accounting for budget appropriations, earmarked funds, implementation of plans, funding, etc.

The fourth principle is that of collation: all the mutual settlements between parties for commercial transactions need to be reconciled. This principle creates a requirement for the mirror-like reflection of debtors' and creditors' transactions, contradicts the prudence principle, and makes accruals impossible in Russian accounting.

The fifth principle is that of the supremacy of administrative law relations. According to this principle, obligations to the superior is always more important than obligations to any third parties. This principle gives rise to the Russian concept of accounting as a predominantly state duty, rather than an essential management tool.

The sixth principle is that of cost-based pricing: the value of assets is determined by their acquisition (manufacturing) cost. Its consistent application led to the establishment of a cumbersome system of accounting for production costs based on the full calculation of costs, endless cost reports, while also causing lots of difficulties in the development of the economy, as, in order to raise the income, producers were invariably pressed to build up their costs, which led to sub-optimal use of material, labor, and financial resources.

The seventh principle is that of the priority of form over substance, or cult of ceremony: the external appearance of documents, their interrelations, the procedure, and the sequence of completing them represent an integral element of accounting; the order is more important than the essence, to appear is more important than to be. This principle is still exerting

considerable negative influence on accounting today and is one of the primary reasons for the differences between the Russian accounting requirements and the international standards. It makes all accounting methods meaningless, substituting them with mere documentation. This approach has its practical expression in the fact that the accounting function refuses to recognize any facts that are not communicated to the accounting office in documents.

ACCOUNTING IN THE RUSSIAN STATE BEFORE THE REFORMS OF PETER THE GREAT (862–1700)

All the principles mentioned above formed themselves in the era before Peter the Great. Documents of the time have preserved evidence about accounting and bookkeeping in the state sector, monasteries, the construction sector, and in industry.

Accounting in the state sector was based on inventory sheets. At the beginning of each financial year, on September 1, tax registers were compiled under the supervision of experienced clerks. Each administrative department was in charge of collecting taxes and maintained a tax register relating to the province of the state that was assigned to the particular department for coverage of its expenses. All the records in tax registers and books of receipts and expenses were kept by towns comprising parts of the province that the particular department was in charge of. At the beginning of each year, last years' arrears were reported with respect to each town with the indication of the types of arrears. The current entries were made against primary documents, with the accounting records for each town being maintained by types of income, which included 127 categories.

Surviving documents of the Manorial Department show that recording expense transactions already required primary documents (extracts or lists) or an order from the superior official, with each primary document being required to carry a resolution from the clerk who was in charge of the particular case, including the amount to be disbursed written in words.

Accounting records were kept in a number of ledgers, with each entry containing the following data elements: (i) date (month, number, sometimes year), (ii) text (name of the supplier or the counterparty, number and quality of the articles received, unit price, total amount), (iii) a note on the nature of the purchased articles (purpose of the articles, the time of the purchase, the purchasing person, the person who compiled the list of expenses),

(iv) a receipt confirming the payment of money, and (v) a note of the application of the purchased articles.

Accounting in monastic households – Monasteries employed a complex procedure for distribution of household responsibilities: the cellarer (or bursar) acted as a general manager, with the treasurer (who was liable for monetary sums) and elders (responsible for specific works or individual types of funds) reporting to him. Special authorized officials (*tseloval'niki*) were elected and sworn in to bear financial liability. An interesting insight into the distribution of duties in a monastery is found in a Charter issued to the builder of Kievo-Pecherskaya hermitage (1701). The Charter provided for: (i) stock-taking and recovery of shortfall from the previous builder, (ii) financial liability for all the valuable items, which was undertaken jointly with the treasurer, (iii) the treasurer keeping the keys to storehouses, with the builder applying seals thereto, (iv) monetary receipts being reported in a special ledger filled out by the builder or the treasurer, with each item of the ledger specifying the sources and dates of the income; following each item, "application of hands" is required; a similar ledger was established for reporting expenses, (v) flour had also to be accounted for in two separate ledgers, the receipts ledger and the expenses ledger, (vi) the same was true of clothes and other stocks, and (vii) completed ledgers relating to a particular year had to be sent to a archbishop (Sokolov, 1996, p. 219).

One very important feature of the 17th century accounting system worth mentioning is the fact that accounting for receipts was always separated from accounting for expenses, which ensured (i) tighter control over assets as, among other things, financially liable persons were not aware of the accounting balances, and (ii) chronological registration of commercial life.

The length of the reporting period varied. For example, according to the receipts and expenses books, the tenure of financially liable persons was as follows: Korniliev Komensky Monastery (1576–1578), one year; Boldin Dorogobuzhsky Monastery (1585–1589), one year; between 1605 and 1607, according to the job position; Bogoslovsky Monastery (1673–1687), one year; Troitsky Monastery, two times a year, in spring and autumn. Reports were accompanied by stock-taking, which involved matching of balances that were not balances in kind with the accounting balances, and vice versa, the accounting balances were verified against the balances in kind. Positive reconciliation of accounting ledgers against the cash stocks, was documented with an entry running something like: "And the receipts matched the expenses (cash stock was added to the expenses), with no losses registered" (Sokolov & Sokolov, 2009, p. 130).

From the beginning of the 18th century, the importance of monasteries in the economy decreased, and in 1764 their land property was secularized.

Several surviving documents from the 17th century contain evidence of the system of accounting in construction and industry, which allow us to reconstruct the accounting system of the time. For example, the restoration of the mural icon paintings in the Moscow Assumption Cathedral in 1642–1643 involved maintenance of the following documentation: (i) a decree; (ii) a budget; (iii) ledgers recording monetary receipts; (iv) ledgers recording cash expenses; (v) separate ledgers recording receipts and expenditure of wheat, glue, wax, candles, paper, nails; and (vi) ledgers recording the works completed.

The files relating to the construction of the first Russian warship, “Oryol,” contains a report dating back to 1667–1671, including a number of ledgers with the following entries: money issued to sworn officials for gear and supplies: 1,710 roubles 23 *altyn* 4 *dengi*; for supplies: 84 roubles 10 *altyn*; the entire construction cost: 9,021 roubles 25 *altyn* 2 *dengi*. These are the first memorial documents reflecting the state of accounting in Russia’s ship-building industry. The construction of a shopping arcade in Archangel in 1670 cost 6,579 roubles 3 *altyn* 4 *dengi* (Sokolov & Sokolov, 2009, p. 131).

Production accounting took its shape in Russia in the second half of the 17th century. For example, potash production was established in Arzamas, and ledgers of Arzamas and Barmino construction camps survive from 1679 to 1680. They contain: (i) a general ledger of receipts and expenses containing data of universal accounting; (ii) a subsidiary ledger (with accounts of individual workers); and (iii) a budget (cost calculation) ledger. The general ledger was completed on the basis of the according records maintained by sworn officials. The payroll in the subsidiary ledger is grouped by residences of persons with and without unauthorized absences (Sokolov & Sokolov, 2009, p. 131).

A study of accounting records kept by Afanassy Fonvisin at Tula and the Kashira metallurgical plants shows the key role of three ledgers: (i) the inventories book containing an inventory and a “staff schedule,” (ii) a receipts ledger, and (iii) an expenses ledger. The accounting function was centralized, records were kept in the receipts and expenses ledgers in strictly chronological order, with no breakdown by specific plants. The expenses ledger was basically a payroll, where a priest or a clerk would put their signature for illiterate workers. The object of accounting was the movement of monetary funds, rather than material resources. Finished products were released without consideration. The state treasury would issue cash for the

reimbursement of current expenses. An accountant would simultaneously perform a cashier's functions (Sokolov, 1996, p. 220).

THE IMPACT OF THE REFORMS OF PETER THE GREAT ON RUSSIAN ACCOUNTING

In the 18th century, the government of Peter the Great openly admitted Russia's backwardness and launched a comprehensive reform that affected many aspects of Russian commercial and social life. Among them, the accounting principles did not avoid a radical overhaul.

Publication of the Regulations of the Administrative Board of Admiralty and Shipyards dated April 5, 1722 was a major landmark in the history of Russian accounting. In this document, one encounters, for the first time in Russia, words such as "accountant", "debit", and "credit." A special ordinance dated May 11, 1722, emphasized the need for the establishment of similar regulations by other large enterprises (Lvova, 2003, p. 89). It should be noted that although the Admiralty Regulations were treated as a model document, they were found to be too complicated and, therefore, a new set of accounting ledgers for the Admiralty was introduced on December 16, 1735 (*ibid.*). The Admiralty Regulations had great impact on the entire system of accounting and bookkeeping in Russia, in particular, on the national-level methods of accounting kept at supplies warehouses, where they consistently recorded all the facts of commercial life in primary documents. Entries that were not supported by documents were rejected.

In an environment where the material supplies for the army, the construction sector, and the industry were tightly regulated, accounting for inventories at warehouses became a key element in the accounting system. The *Proviantmeister* (logistic manager or paymaster) running army warehouses, along with army inspectors, submitted monthly lists of inventory balances to the State Supplies Board. At the end of the year, or in case of suspicion of any irregularities, full stock-taking would be undertaken.

Accounting made significant advances at the metallurgical plants of the Urals. Their founder, V. I. Gennin (1676–1750), a Dutch engineer who served as a Russian military officer and was the most outstanding expert in metallurgy of the 18th century, developed a comprehensive accounting system. For example, accounting for finished products involved fixing a billboard at each blast furnace, where the foremen would record the quantity of finished products manufactured, along with the quantity of the raw materials processed.

And every Saturday, having copied the information from the boards in tables on semi-sheets, the foreman should submit it to the supplies office, to make sure that record is kept of the receipts and expenses and for better order of accounts. The supplies office, on the other hand, shall keep the tables submitted by foremen in a particular book, collecting them into stacks. (Gennin, 1735, p. 160)

To account for the time worked, the foremen were required

[T]o record who was where, on which day and at which work, and, upon the expiry of the month, the foreman, or whoever is ordered to do so, is to submit such list, with his own certification, to him, the director, while the latter is to certify it, and, if issued properly, write to Siberian Oberbergamt (State Plants Administration) for the payment of money. (*Ibid.*, p. 108)

Where the business is handed over by one foreman (steward) to another, assets in the responsibility of the first foreman are to be handed over following a stock-taking. The foreman who assumed responsibility for the affairs would put his signature under the stock-taking list.

During Peter the Great's rule, organization of accounting was overhauled as a result of the administrative reforms undertaken in the state, with numerous legislative acts and instructions adopted, many of which were, obviously, copied from the Western (primarily, Swedish) practice (Miliukov, 1892, p. 722). This restructuring had two objectives: (i) to strengthen the control over the integrity of the property; and (ii) to boost the state revenue.

Russian industrial accounting during Peter's rule made substantial advances. The government established for the first time an obligation for state enterprises to maintain complete records of all facts of commercial life by ensuring regularity in stock-taking and reporting, applying more advanced cost calculation methods, a linear-entry system in accounting, and an analytical approach to information, which was necessary for the administration of individual structuring units of enterprises. On the other hand, industrial accounting was not based on the double-entry system.

The first book on accounting and bookkeeping published in Russian was *Cluch commercii* (*The key of commerce*) in 1783. It was a translation of a well-known English textbook by John Hawkins dating back to 1689.

The first Russian books on accounting and bookkeeping were written by leading accountants K. Arnold (1775–1845), I. Akhmatov, and E. Mudrov, who are justly called the founders of the Russian accounting school. Karl Arnold was the first accountant to draw the distinction between the theory and the practice of accounting. He treated the former as the “ability to make accounts, maintain, and review them,” and the latter as “the circle of all the activities pertaining to accounts”; the latter being perceived as “accounting science” and the former as “accounting part” (Arnold, 1814, p. 1).

The objective of accounting science, according to Arnold, is to reveal the reasons for changes in the composition of property, while its subject matter are "things capable of multiplication or reduction ... insofar as they contain in themselves some merit expressed in their price" (*ibid.*, p. 4). His treatment of the subject matter of accounting as "things" restricted its subject matter to property relations and overlooked the liability-based relations. Arnold was the first author in Russia to use mathematics to explain the double-entry system.

In 1809, when Arnold's work circulated in Moscow, Ivan Akhmatov published a book entitled, *Italian, or Experience-Based, Accounting*, in St. Petersburg. In this work, which reflected the influence of M. de la Porte, we come across for the first time a statement implying that accounting is part of the political economy but, despite the fact that it is just a part, one could say that "it is the most essential, important and useful science."

One important event in the history of Russian accounting thought was the publication in 1846 of a book by Erast Mudrov. The author divided all accounts into property-related, person-related, and ancillary, which, according to him, included accounts of own resources and economic results. Mudrov insisted that the double-entry system results from the very nature of the commercial turnover. In his writings, we also find Schär's equation of capital. Mudrov established this equation ($a - b = c$, where "a" is asset, "b" is accounts payable, and "c" is capital) in 1846. In the same year, this balance equation had the following form: $a = c + b$.

ACCOUNTING AFTER THE GREAT REFORMS OF THE MID-19TH CENTURY

The development of capitalism in Russia, initiated by the 1861–1874 reforms of Alexander II (1818–1881), was accompanied by an ever-increasing amount of publications in the field of accounting practice and education. The number of commercial schools with accounting courses more than doubled (from 3 to 8 at the end of the 19th century, in which an average of 500 students studied). Commercial education needed a significant increase in educational and scientific literature on accounting this led to the appearance of scientific schools, created around professional journals.

The dominant position was held by the school created by the authors of the first Russian accounting journal *Schetovodstvo* (1888–1904), edited by A. M. Wolf (1854–1920). He was not an original scientist, but had distinctive organizational capabilities which enabled him to concentrate a

group of notable accountants and renowned scientists, who had formed the scientific basis of the Russian accounting profession, around the related journal. These were L. I. Gomberg, E. E. Feldgausen, N. I. Popov, and Eduard Grigorievich Valdenberg (1836–1895), the first Russian historian who translated Pacioli's treatise.

Lev (Leon) Ivanovich Gomberg (1866–1935) was known both in Russia and Europe. He was elected as a corresponding member to the Accounting Academic Society in Paris and was a fellow of the International Accounting Association. He was regularly published in *Schetovodstvo* (Gomberg, 1898, 1902, 1903), and he issued a number of fundamental papers in Russian (Gomberg 1895, 1898). His papers translated into French (Gomberg, 1912, 1928) and German (Gomberg, 1927) were popular in Europe. Gomberg was born in Cherkassy (Ukraine) and began his career in St. Petersburg as an industrial (mill) accountant and finished it in Switzerland, where he "had to move due to poor health" and where he stayed and became internationally known as a pedagogue and a prominent theorist in accountancy. He called accounting science "economology," i.e., economic logics and divided it into six components: (i) evaluation, (ii) inventory, (iii) estimate (budget), (iv) accounting, (v) reporting, and (vi) control.

Eduard Eduardovich Feldgausen worked on industrial cost accounting. He called his method "normal factory accounting" (Feldgausen, 1988). In a sense, Feldgausen's method can be considered a Russian prototype of the "standard-cost" method.

Nikolai Iustinovich Popov (1843–1921) was known in Russia and Europe as a scientist who was the first to suggest using algebra for explaining double entries. Popov considered this approach the best for disclosing the structure of accounting records and facilitating the review of entries. Using algebraic methods, he proved that different accounting formulae were a mere modification of accounting entries and, consequently, no other system is possible. He was absolutely convinced that he thereby proved the pseudo-novelty of the newly appeared innovators and, at the same time, the inadequacy of any paradigm other than double-entry accounting. All types of accounting are built on Pacioli's postulate and it is impossible to fall outside these limits. However, Popov considered accounting science as pure economics and a double entry as objective law. His "mathematical accounting method" (Popov, 1906) was referred to by Tsimaras (1932) and Vlaemminck (1956).

The spokesman of *Schetovodstvo's* opponents was Fedor Venedictovich Ezersky (1836–1916). He considered that the accounting object is movement of capital, which goes through three phases: money – assets – money. Actually, Ezersky took the "American" bookkeeping system (elaborated by

Degrangé in the beginning of the 19th century), whose classic version stipulates five accounts: (i) money, (ii) debtors, (iii) assets, (iv) creditors, and (v) capital. Ezersky called his accounting system "Russian triple-entry accounting system." It allowed the determination of the financial result at any time as equity balance. Ezersky's first work on triple-entry accounting, *First Public Experience with the New System*, was published in 1870 in Dresden, where he studied accounting treatises. In 1873, on his return to St. Petersburg, Ezersky started to actively promote his system in Russia and published the book, *New System of Merchandise Accounting*, followed by many other publications. Ezersky founded training courses (he saw the task of disseminating his ideas in educating youth on a mass basis) and became one of the first founders of mass accounting courses in Russia – in St. Petersburg and Moscow, he created an "accounting *artel* (cooperative)," read lectures in various institutions, and even sent his books to the Tzar. Since 1889, Ezersky founded the *Schetovod* (Accountant) journal. On October 2, 1892, Ezersky created the Accounting Association in Moscow, whose main tasks were to unite accountants and organize mutual support (material, employment, etc.). In 1911, at the International Congress in Charleroi (Belgium), Ezersky's triple-entry theory was recognized internationally and many prominent representatives of the academic community recommended that it should be included in academic programs.

In criticizing the Italian system, Ezersky suggested, instead, his idea that "the double-entry system requires to have the same in expense and in receipt, expense should be equal to receipt, while the triple-entry system requires that there should be receipt and expense and something should be left for the owner" (Ezersky, 1909, p. 2). He insisted that there are fundamental differences between these systems:

- (i) external – in the number of books,
- (ii) internal – in the number of columns in the books, and
- (iii) qualitative – accuracy features.

Ezersky notes the following weaknesses in the double-entry accounting system:

- (i) imperfect terminology, as a result of which loss (debit) is called receipt, and profit (credit) is called expense;
- (ii) use of "dummy" accounts for accounting own funds;
- (iii) accounting is artificially divided into "dead" (general ledger accounts) and "live" (individuals accounts);

- (iv) financial result can be derived only by means of stock-taking and for the expired period of time; and
- (v) coincidence of the results in the double-entry system creates the illusion of correctness of accountants' work. Errors connected with misallocation of amounts and errors in physical terms are not identified through the double-entry mechanism either (Sokolov, 1996, p. 246).

According to Ezersky, corresponding records should be built differently. When there is a receipt but no corresponding expense, capital or profit increases. On the contrary, when there is expense, but no corresponding receipt, capital or loss decreases. For example, accounts "Goods" and "Settlements with suppliers and contractors" are used improperly. Ezersky insisted that receipts of goods should be accounted for as "Dr (Receipt) Assets/Dr (Receipt) Capital." This is the company's capital until the amount is settled.

Thus, it is on the "Capital" account that the company's financial results were concentrated. They were reflected on the "Capital" account and one could always see the financial result by comparing the current balance with the previous balance. However, it was misstated by the difference between payables and receivables. Moreover, profit in the Russian triple-entry system was misstated due to the impossibility of accounting for interest on securities every other minute, as well as accrued rentals, payroll expenses, depreciation of fixed assets, etc.

However, this inaccuracy does not damage the clarity of matters, and it would be ultimately unreasonable to force accountants to make cumbersome daily computations which make no practical sense. For practical purposes it would be quite enough to be able to see daily a more or less approximate capital balance with the precise amount, including all stated minor computations, being shown when necessary. (Ezersky, 1908, p. 12)

Ezersky tried to solve the key management task, i.e., monitoring the company's efficiency on a real-time basis. The problem is that the financial result can be determined only after the balance sheet is prepared. In addition, there is a certain time gap between the date of the balance sheet and the date on which it was prepared. According to Ezersky, the new form of accounting ensured that profit was calculated after each economic transaction.

The system should show clearly, on a day-to-day basis, not only unrealized expenses, but also payroll, cash, and assets in arrears – immediately, without data selections. If an accounting system does not provide answers to these questions, but resorts to a special data selection, this system cannot be called adequate (Ezersky, 1913, p. 2).

Ezersky's system is called "simplified" because it is easier than all other existing systems; it could not be any easier than simple entries because it deals with only three books – the most important and necessary ones, which show movements in chronological, systematic, and consolidated order. It is also called "triple-entry" because of the three books, "Ezersky's" – after the author, "Russian" – by origin, and "self-verifying" – because of its mathematical formulae, accuracy features, facilitating review of records in the books, and adjustment of errors, if any (Ezersky, 1913, p. 2).

FORMATION OF PRINCIPAL RUSSIAN ACCOUNTING SCHOOLS: MOSCOW AND ST. PETERSBURG

In the early 20th century, the two Russian accounting schools, St. Petersburg and Moscow, were finally formed, which opposed each other for almost half a century.

The St. Petersburg school was set up based on the Russian Accounting Society of Mutual Assistance (1907) headed by Evstafy Evstafievich Sievers (1852–1917). He called knowledge on accounting practice *Schetovodstvo* (bookkeeping) and accounting science *Schetovedenie* (accounting). This approach was widely recognized in the Russian accounting literature up to 1929. Sievers divided the accounting theory into two parts: a general accounting theory and a bookkeeping theory describing the methods of maintaining different registers, where registers meant books. He interpreted the book theory as the science on accounting methods. Registers included statements which helped record the goods during the day by their number in the columns with different prices, so that the rating for the value estimate was performed only once.

Sievers is known for explaining the exchange theory. He stated that the double entry was based on the assets exchange and concluded that it was the main accounting law, i.e., he treated the double entry as the law of nature, e.g., the law of gravitation. Sievers believed that the regulation on exchange was the reason for the double entry and concluded that the balance sheet resulted from the accounts. That led to regulation on the independence of the balance sheet from the inventory and debit and credit homogeneity in all accounts (one-chain accounts theory). Students should be taught based on the "account-to-balance sheet" scheme, which complies with the balance sheet practical sequence and origination theory.

Sievers did a lot in the educational sphere. Earlier, accounting was taught based on practical examples. Students got blank forms of original books and had to complete them assisted by their teacher. In Sievers' opinion, students should be taught the accounting substance, rather than the bookkeeping technique. Technique could be learned in practice only, while the accounting substance could and should be taught in the classroom. Instead of blank forms, his students filled in the account schemes – T-accounts or “aeroplanes,” as they called in Russian. He introduced the schemes to record business movements, where accounts were shown as some shapes and the entries were presented as straight lines connecting those shapes (Sievers, 1915, p. 282). Later, that method was the key in Schmalenbach's graphical design.

The Russian Accounting Society of Mutual Assistance, headed by E. E. Sievers since 1909, published the *Kommercheskoe obrazovanie* (*Commercial Education*) (1908–1916) journal with articles written by such prominent accountants as A. I. Gulyaev and N. F. von Ditmar.

Alexander Ivanovich Gulyaev (1877–?) was Sievers' assistant. He specialized in industrial accounting and his theory on the cost structure was widespread. The cost included: materials, salary, energy costs, and depreciation, with the last two expense components included in cost if they were involved in creating a certain product. Ever since, this classification has served as the basis for presentation of cost by nature in financial statements. Gulyaev recommended that the overhead expenses be allocated proportionately to salary. He also recommended using analytical accounts based on the preset, so-called “accounting” prices. The difference between the actual and estimated cost was recorded on the income and expense account (Gulyaev, 1905). In his accounting theory, Gulyaev followed Sievers' ideas, but thought that the main laws of nature were the laws of conservation of matter and energy and claimed that the double entry was based on the general law of exchange inherent to the nonorganic, organic, and social world (Gulyaev, 1909, pp. 12–13).

Sievers' ideas were also followed by Nikolai Fedorovich von Ditmar (1865–1919), an engineer. His attitude to the general accounting theory was based on the following definition: “Bookkeeping by methods of its transactions is a section of the applied mathematics governing the economic component of life” (Von Ditmar, 1912, p. 5). He defined business transactions as those “expressed in origination, change, prevention, modification and elimination of assets and obligations” (*ibid.*, p. 12). Ditmar thought that the double entry was based on the key economic rule: the outflow is equal to inflow. Like Gulyaev, he proved his ideas using the main physical laws of

conservation of matter and energy. He divided all accounts into personal, material, and abstract (calculation and profit and loss account). As he put it, "As the outflow is equal to inflow, there may only be double accounting."

The Moscow school based itself on the balance sheet theory. Its founders, N. S. Lunskey, G. A. Bakhchisaraitsev, F. I. Belmer, and A. K. Roschakhovsky, thought that accounts were the balance sheet components, the system of accounts was driven by the balance sheet, and a part could be understood together with the whole. Accounting should be taught on the balance-sheet-to-account scheme. The balance sheet was regarded as the simplified form of inventory and was independent of the chart of accounts. The accounts were divided into two contradictory groups: assets and liabilities. The double entry was treated as a result of the double grouping of accounts in the balance sheet, rather than the objective exchange law.

Nikolai Sevastyanovich Lunskey (1867–1956) was the author of the balance sheet theory. He treated the whole accounting theory as a method used to make the "most complex accounting things," i.e., entries, which required getting an insight into the balance sheet structure. Lunskey gave a balance sheet definition applied in all Russian tutorials: "General balance sheet is a table used to compare company's fixed assets with its sources; this balance sheet reflects the current economic and legal position of the company" (Lunskey, 1913, p. 191). He applied the "liabilities" definition to equity, but had to use a new term – source – to formulate the contents of the liabilities. That term became commonly used in the Soviet time. That was a new definition of debit and credit: debit is the left side of the account, while credit is the right side. These definitions made sense only when viewed together with assets (active) and equity plus liabilities (passive). As a result, the accounts were divided into active and passive accounts (two-chain accounts theory). The accounting categories lost their substance. Accounting turned into a method lacking any specific contents. However, external simplicity and ease of use made this theory very popular.

The second prominent representative of the Moscow school was Georgy Avksentievich Bakhchisaraitsev (1875–1926). He further developed the balance sheet accounting theory. His ideas were formulated in 31 notions. Here are some of them: the balance sheet reflects the quantitative position of a company: (a) in one table and (b) in a chart of accounts. Asset is what a company received; a liability is what a company owes (source). All methods of the applied accounting should be based on the balance sheet notion. The balance sheet is what the accounting starts and ends with. Theoretically, debit and credit terms are not necessary. Account are an organic part of the balance sheet. Account-to-balance sheet ratio is mathematical: the whole is

equal to the sum of its parts. It is impossible to study accounts prior to the study of the balance sheet. Accounts are divided into assets and liabilities. All liabilities are personal accounts (Arseniev, 1908). Bakhchisaraitsev was the first among the Russian accountants to divide all business transactions into four types by their impact on the balance sheet. These types are known to all accountants:

- (1) $A + a = P + a$
- (2) $A - b = P - b$
- (3) $A - c + c = P$
- (4) $A = P + d - d$

where A, asset; P, liability; a, b, c, d, economic events that change the composition of the balance sheet, but not the underlying equality. Transactions (1) and (2) are modifications and (3) and (4) are permutations.

Fedor Iogannovich Belmer (1873–1945), the third founder of the Moscow school, emigrated to Bulgaria during the Revolution and created the Accounting Bulgarian school. Being a conservative, Belmer developed the balance sheet theory and claimed that the balance sheet was independent from the general ledger and the chart of accounts. He was first to demonstrate that the balance sheet had lines, rather than accounts, and that the “balance sheet table might not be equal to the balance sheet of the general ledger by contents or results” (Gulyaev, 1909, p. 27). Belmer therefore opposed the bookkeeping to financial accounting, an idea that is currently argued under International Financial Reporting Standards (IFRS). He believed that only chronological entry might be the basis of the accounting and highlighted the dominance of accounting over the general ledger (*Commercial World*, 1909, No. 3, p. 95). In 1907, Belmer headed the Moscow Accounting Society, with all founders of the balance sheet theory being its members. The Society published its articles in the journal, *Kommercheskiy mir* (*Commercial World*, 1906–1910). In 1909, the Moscow Accounting Society held the All-Russia meeting of accountants and, then, having spent all its funds on meeting preparation, ceased to exist.

Afinogen Konstantinovich Roschakhovsky created what later became known as “balance sheet maintenance.” His theory was based on Lunsky’s ideas, and he proposed a standard balance sheet structure of a joint-stock company (Roschakhovsky, 1910). The level of detail of certain balance sheet items was at the discretion of the balance sheet makers. As for other balance sheet items, Roschakhovsky determined elements to be identified in the balance sheet. In his article, *Imuschestvo Realnoe* (Real assets), he identified five elements: (i) cash (cash on hand, accounts with banks); (ii) membership

fees; (iii) securities; (iv) permanent property (real estate, movable property, construction in progress); and (v) properties in turnover; the capital line included core capital, additional capital, working capital, reserve capital, insurance capital, repair capital, *del credere*, premium reserve, and charity capital.

ACCOUNTING AFTER COMMUNIST REVOLUTION (1917–1929)

All disputes and scientific discussions stopped immediately after the 1917 October events. Everyone in Russia remembers Lenin's phrase: "Socialism is accounting and control." However, few people know that accounting was fully destroyed by the new authority.

Everywhere or almost everywhere accounting books are in chaos, they are poorly controlled and are not connected, accounts are weakly classified and maintained, entries and balance sheets are provided with delays, inventories are poorly compiled and are incomplete; balance sheets are nontransparent and inaccurate. In brief, routine, negligence and duplicity are used to deceive either the third parties, or the owner, especially when the latter is represented by the government. (Rudanovsky, 1924)

Accountants were unwilling to tolerate such a state of affairs. At the end of the Civil War in 1921, the authorities began to realize that it was impossible to revive the economy without appropriate accounting. As a result, the New Economic Policy required, *inter alia*, new solutions in accounting as well.

We can distinguish several prominent accountants of this period. The Moscow school revival is associated with R. J. Weitsman, A. M. Galagan, and A. P. Rudanovsky. The Leningrad (former and nowadays St. Petersburg) school also had notable representatives: N. A. Blatov and I. R. Nikolaev.

Russian accounting was affected by German accounting since the time of Timerman, who was appointed accountant by Peter the Great. That impact was particularly felt in the 19th century. Rakhmily Jakovlevich Weitsman (1870–1936) was the last supporter of the German school in Russia, where he championed and promoted the classical accounting theory of double entry developed by J-F. Schar, A. Calmes, P. Gerstner, and H. Nicklisch. Weitsman insisted on the tripartite balance sheet formulae where debt liabilities and equity were separately identified.

Sievers' ideas of the St. Petersburg (Leningrad) school were followed by Nikolai Alexandrovich Blatov (1875–1942). He claimed that the double entry always reflected the natural exchange of assets by an enterprise. That was a vivid example of the economic substance. But the focus was placed on the exchange of assets, rather than on the assets themselves. Blatov conceived a special model reflecting all possible types of exchanges recorded using the double entry. This model is known as “Professor Blatov’s quadrate.” The impact of the exchange theory was strongly felt in the Russian literature, as all theorists who recognized the objective feature of the double entry based on the movement of funds supported his ideas (Blatov, 1930).

The leading figure of that time was Ivan Romanovich Nikolaev (1877–1942). He thought that naive and demagogic requirements arising from the accurate balance sheet were utopian and could not be met. Accounting should reconstruct the business process for further efficient management. Moreover, Nikolaev thought that accounting should provide information that could be used for management purposes and affect the decision-making process. He considered additional information unnecessary, if it had no impact on the administrative and management decisions. Nikolaev adhered to the following rule: when turned into cash, assets could affect the income and expenses. Therefore, he was one of the first, or perhaps the first, in Russian accounting literature to claim that disposal could occur only upon cash receipt (Nikolaev, 1926). In 1965, the cash basis of revenue recognition became the national scientific doctrine. Noncompliance with the cash method in preparing the accounting records was viewed as a criminal offence or misstatement of public accounts by recording unearned income. The cash method for revenue recognition was rejected in the 1990s during the period of political and economic reforms.

One of the most prominent Russian accountants whose work determined the development of the accounting theory and history was Alexander Mikhailovich Galagan (1879–1938). He was one of the most talented students of F. Besta (1845–1923), the leading Italian scholar at the end of the 19th century and beginning of the 20th century. Galagan was one of the first in our country to acknowledge that Besta, Alfieri, Rigobon, and Ceccerelli had stated that many trading companies in Italy maintained their accounting books in compliance with all bookkeeping rules long before the appearance of the first printed work on accounting (Galagan, 1927, p. 56). He was familiar with the accounting historians who represented other European schools, e.g., Brawn (1905).

Galagan's criticism toward his teacher sometimes provoked indignation, however in particular, he wrote that:

In his theory, Besta focused on the accounting subject. Having capitalist views, Besta thought that the key feature of each subject of business operations is captured by its value, rather than in its material substance, as the subject's value determines the meaning of the subject to business. Therefore, Besta concluded that the subject of business operations and the accounting subject lie in their value, rather than in their items. Besta's views are provided for in his theory called the value accounting theory. (*Ibid.*, p. 161)

Nevertheless, we should bear in mind the time when Galagan lived and wrote his book, as well as the relevant requirements that were set. His book is one of the best historical researches of his time. However, many regulations proposed by him or other scientists, whose views he shared, could be challenged. This is only natural, as science and accounting history forge ahead.

The most prominent Russian accounting scientist of the first half of the 20th century was Alexander Pavlovich Rudanovsky (1863–1934). His ideas are still interesting today. Many of his views on accounting as the model of the company's financial position become relevant in the crisis environment. Crisis, in particular the loss of confidence in the economic data, requires new vision on the methodology of preparing the financial statements. Rudanovsky worked as an accountant during his entire life, first at the railway stations, then as a chief accountant at the Moscow Administration (municipal services); in soviet times, he was chief accountant in different states companies. He was, however, at the same time a prominent scientist.

His first (and now well-known) book was *General Accounting Theory and Assessment of Current Status of Accounting Theory and Practice of Moscow City Accounting* (Rudanovsky, 1912a). The author commented on the Audit Committee's expert opinion on maintaining accounts in the Moscow administration. That opinion contained numerous comments that made the chief accountant very angry. As a result, he decided to write a book with his explanations. This book determined the vector of his further research. In his introduction, he pointed out that the most important feature of accounting was its alignment with the specifics of the company's activity and compliance with the needs of those who carried out this activity.

If accounting fails to focus on the specifics of the company's activity, it loses any sense ... Situations when methods used in one company are applied to the other company without being aligned with its specifics, tasks and objectives give rise to more complex and serious consequences. (Rudanovsky, 1912b)

This is an important concept. Accounting for the sake of accounting has no sense. The value of any accounting system is directly proportionate to its compliance with the information needs of users who are determined by the specifics of the relevant company.

The point is that Rudanovsky differentiates between the balance sheet being a result of an accountant's work and a company's balance sheet as an economic category. The latter exists irrespective of whether an enterprise maintains accounting records or not, or how these records are maintained. The company balance sheet as a relationship between the company's sources of resources and the areas for their investment exists on its own. It exists because the company exists rather than because its operations are accounted for, whereas an accounting system is a set of methods used to present the balance sheet in the form of the accounts balances, which may match the company balance sheet only to a certain degree. The degree of such conformity is determined by the level of sophistication of the accounting methodology. The more there is such conformity, the better the accounting system is and the more sophisticated its methodology should be. That gives rise to a more important point – accounting reports cannot provide a 100% accurate and complete record of the company's financial position to the users. And this is normal because accounting reports represent just one model which characterizes the company's state of affairs in a certain way. The model cannot be identical to its object. To believe the contrary means to be seriously misled.

Also in 1912, Rudanovsky published his paper entitled "General Accounting Theory" (Rudanovsky, 1912b). He understood the balance sheet, which exists objectively in the company itself, as the focus of accounting. He believed that accountants merely reproduced it by building various models. It is obvious that the more sophisticated the model is, the more it reflects business transactions as such. If the balance sheet is acknowledged as absolute truth, and the model used in practice is considered to be relative, we can make a number of valuable conclusions on the accounting system: (i) accounting records reflect only a part of the economics and the information used in them has rather relative value, and (ii) development of the accounting theory should be aimed at the creation of such accounting models that would ensure the most complete reflection of business processes. Therefore, accounting records should reflect not only discharge of obligations, but also liabilities arising from the underlying contracts.

In Rudanovsky's opinion, accounting and measuring financial results (profit and loss), i.e., the company's liabilities, should not be linked to

evaluation of the company's property, i.e., its assets. The company's assets and liabilities are not different groupings of the same capital represented in monetary terms, but absolutely independent elements of the company's financial position. Their equality shown in the balance sheet is artificial and their real monetary value should not be the same. Therefore, equality of assets and liabilities in the balance sheet disguises a natural imbalance between monetary valuations of the company's property (resource) base and sources creating this base. This important conclusion has yet to be properly evaluated by our colleagues both in Russia and abroad, and its disregard represents the disregard of the most material limitations on the information capabilities of the modern accounting framework based on the balance sheet model of economic entities' financial position.

Rudanovsky was an author of several methodology guidelines. One of them, the methodology of depreciation recording, was applied in the national planned economy for over 60 years. It was based on the integral attributes of the economic system of that period: (i) the uniform prices for subjects of business operations (products, work, or services) across the country; (ii) the uniform method of depreciation (straight-line basis) applied to all types of business operations; and (iii) the uniform rates for depreciation charges applied in centralized pricing of subjects of business operations; application of the same rates to depreciation by economic entities.

The significant element of Rudanovsky's methodology is application of the cash basis as a uniform method of revenue recognition. In this case, real cash is applied to renewal processes, rather than buyers' and customers' promises to repay accounts receivable within the set limits.

ACCOUNTING IN THE U.S.S.R. DURING THE STATE-CONTROLLED ECONOMY (1929–1991)

In the 1930s, after the establishment of the Stalin dictatorship, important changes occurred in accounting. Notwithstanding the established real socialism, Sokolov (2004) wrote that, "[I]t is an error to believe that this period was useless for accounting. Precisely at that time, the people who managed national accounting proposed and implemented numerous fruitful ideas in accounting practice." He cited as examples the following:

- (i) No "fixed assets" category existed prior to 1930. These were called property, premises, constructions, equipment, etc., but Soviet accountants

aggregated these items in one category. They also introduced the concept of cost criterion, which allows to distinguish clearly between fixed assets as such and small-value and short-lived items.

- (ii) Disposal and depreciation were recognized as parallel processes. The former was treated as a loss of property and the latter as accumulation of the recovery (renovation) fund.
- (iii) Recording of capital investments was separated from recording of core operations of entities (assigned to a separate balance sheet). One thing is when a retailer sells goods, another when it builds new premises.
- (iv) Designated funds – payments during the year from earnings.
- (v) Retention – allocation of profit to the different parts of earnings called funds (reserves) after approval by a controlling company.
- (vi) Permanent liabilities – accounts payable permanently present in the company's balance sheet. They were treated as equity.
- (vii) Chart of accounts. Following studies by Schmalenbach and Dumarchey, Russian accountants prepared a general chart of accounts for all companies (except banks), which has existed (with some changes) since the beginning of the 1960s until now.

Y. M. Galperin, N. A. Kiparisov, N. A. Leontiev, V. I. Stotsky, and M. H. Zhebrak achieved much recognition in accounting theory, which, starting in the 1930s, lagged behind practice.

Galperin (1894–1952), Kiparisov (1873–1956), and Leontiev (1893–1958) developed the balance sheet theory which received public status and was acknowledged as the only possible conception. Thus, aspects related to the balance sheet theory were not considered separately and all scholarly disputes were devoted to problems associated with the subject of accounting, accounting method, and classification of accounts. These problems seemed to carry a very large element of external scholasticism; however, the discussion on these issues was profound. For example, some specialists insisted that primary documents refer to elements of the accounting treatment, while their opponents considered that they represent a technique within the accounting treatment, rather than elements. Based on the first concept, an accountant, with the help of primary documents, records the company's economic activity, which represents the subject of accounting. On the contrary, based on the second concept, an accountant, definitely, records neither economic processes nor the company's property or liabilities, but only information generated by them. Administration is not about economic events as such, it is only about recording thereof in the

accounting registers. In general, the first concept prevailed both in theory and practice.

However, the greatest Russian achievements after 1930 were associated with cost accounting and calculation of the cost of ready products, work, and services. Before the war, Vladimir Ivanovich Stotsky (1894–1941) set forth the principal idea that calculation depends on the purpose and showed that the number of calculations in the limit is infinite. The essence of a properly organized accounting system therefore comes down to an adequate selection of purposes. Stotsky's achievements also include a classification of calculations (Stotsky, 1936). The difference he established in the classification of production expenses by dividing them into direct and indirect, and general and overheads has become an important scientific patrimony. He also showed that the normative method does not supplement traditional methods, but is a conceptually new solution of problems associated with cost accounting and cost calculation.

The main proponent of the standard costs concept in the U.S.S.R. was Moisei Kharitonovich Zhebrak (1889–1962). The key issue in the standard costs concept is the correlation of cost accounting and calculations. This issue was actually raised in the mid-1960s by N. G. Chumachenko and E. K. Hilde, who noticed that these are basically different accounting tasks. Many people did not accept this idea; however, this issue has a long history. Russian accounting theory suggested four solutions of this problem: (i) calculation conditions cost accounting, (ii) cost accounting conditions calculation, (iii) calculation and accounting are identical, and (iv) calculation and accounting are independent of each other.

At the end of the soviet period, the accounting tradition was taken up by a prominent scientist, Erikh Karlovich Hilde (1904–1983). He demarcated cost accounting and calculation, and focused on the first issue – cost accounting – and successfully applied modeling in solving this problem. The substance of this approach was that cost accounting schemes were projected not on industries, but on the technological type of the production, which created conditions for forming a single cost accounting scheme without regard to industry profile. It must be noted that when Hilde began his research, there were 58 industry instructions in Russia, and his models allowed deriving a matrix for each technological process, which created conditions for controlling actual costs on each item and each responsibility place (center), which significantly facilitated economic process management. Matrix cost accounting should ensure reasonable promptness of economic events recording. Reasonable promptness should be understood as the period between occurrence of the event and

registration thereof, during which efficient management decisions are made (Hilde, 1970).

ACCOUNTING AFTER THE COLLAPSE OF THE U.S.S.R.

On the eve of the 21st century, the collapse of the Soviet Union was accompanied by a steady increase of the need for new accountants. In the 21st century, the number of accountants has amounted to some three million. Interest in the profession has increased, and so has the number of publications, and new scientific schools and directions have also appeared. Such a school was actually created in St. Petersburg back in the 1970s (Leningrad at the time) around the Club of Accountants. Its base was comprised of students and followers of Professor Yaroslav Vyacheslavovich Sokolov (1938–2010).

The basis of Sokolov's views in the area of the theory of accounting is the conceptual reconstruction of the facts of economic life. According to this theory, an accountant reflects facts of economic life, which are the subject of accounting, in a situation where most of these facts have already taken place. By registering facts, an accountant performs their conceptual reconstruction. As a result, a fact unites the objective (i.e., what actually took place) and the subjective (i.e., what the accountant sees in the fact being reconstructed based on the objectives set before him or her). The conclusion that follows from this is that the fact reconstructed by an accountant is always inadequate in relation to the actual fact. The conceptual reconstruction of a fact has two levels: internal and external. The first reveals the structure of the fact and is represented by two aspects: legal and economic. The second level is about the reconstruction of a fact in time (past, present, and future valuation of a entity's activities in the past, future, and present) and in space (four types of entries described by Arseniev (Bakhchisaraitsev), 1908), which makes it possible to create four "chess-board" balance sheets (matrices) and switch, in accounting, from methods of registration to methods of calculation, which is the result of conceptual reconstruction. Both in valuation and in making accounting entries, conceptual reconstruction leads to many variants, which significantly expand the possibilities for accounting methodology. Behind accounting information, there is always its user, the entity on whose behalf the reconstruction of the fact is undertaken. Its needs dictate the methodology of accounting and fully determine its results; therefore neutrality in accounting cannot be achieved in a natural way, it can only be artificially

introduced by an accountant, who demystifies the accounting, i.e., identifies and discloses the interests of the parties on whose behalf the accountant works. Any attempt to bring together the interests of different entities by using unified accounting rules, to express fully the multiface nature of fact in one balance sheet – something to which accounting practice returns time and time again – only harms accounting and makes it not integral but, instead, eclectic. This happens because accountants en masse do not see any problems in their science, as it were; for them, any problems that may arise are confined to the technique of processing or presenting of the information, whereas the focus should be primarily on the foundations of the actual science, the methods by which an accountant learns about the world around him or her – the world that consists of facts of economic life (Sokolov, 1976, 2000, 2010).

Yaroslav Sokolov can be called the father of Russian accounting history. Before him, only a few researches were published in Russian. The first book on the history of accounting in a global context was published in Russian by Sokolov in 1985, subsequent works of the author substantially widened the volume of materials, and, in 1996, he published a monograph, “Accounting: From its beginnings to our day” (Sokolov, 1996), on the basis of which a textbook was written, *Бухгалтерский учет: от истоков до наших дней*, which was the most comprehensive study and served as the basis for the popular textbook on the history of accounting that is included in the curriculum of all Russian universities teaching accounting. In addition to this, Sokolov corrected the translation of Luca Pacioli made by Valdenberg (1836–1895) in 1893, and published the first biography of Pacioli in Russian (Sokolov, 1974).

As a member of the Methodological Committee on Accounting of the Ministry of Finance of the U.S.S.R., and then of Russia, which was in charge of discussing accounting standards and professional regulations, Prof. Sokolov constantly insisted that accounting be a self-regulatory profession. He obtained the creation in 1997 of the Institute of Professional Accountants and was its first president (1997–2000).

Works on the history and theory of accounting, begun by Sokolov, are continued by his students.

MODERN ACCOUNTING FROM 1991

Statutory Requirements

Accounting in Russia is regulated by state authorities. The regulatory framework for Russian accounting has three levels. The first includes the

law on accounting, the Civil Code, the law on joint-stock companies, etc. The second level consists of Russian Accounting Standards (RAS). The Central Bank of Russia is responsible for setting standards for banks and other credit institutions, while the Ministry of Finance performs this function for all other companies. The third level is the accounting policies and internal accounting documents of a given company, which are developed based on the first two levels. Each company keeps its accounting books and prepares its financial statements in accordance with its approved accounting policies.

Preparation of Financial Statements: Form and Content of Statutory Financial Statements

The only financial statements acceptable for filing purposes are the stand-alone statutory financial statements of a legal entity registered in Russia. The structure, presentation, and procedures for preparation, as well as other aspects of statutory financial statements, are stipulated in the Russian Accounting Standard "Financial Statements of a Company." Financial statements should be prepared in Russian roubles and in the Russian language, and a company must submit its annual statutory financial statements to:

- Its stockholders, in accordance with its foundation documents.
- The state statistics authorities.
- The state tax authorities.

The basic annual statutory financial statements, called accounting reports, include a balance sheet, a profit and loss account, and notes to both (the cash flow statement and the statement on changes in equity constitute a part of the notes). For qualifying small businesses, a simplified set of accounting rules is allowed. The reporting year is the calendar year.

Publication of Financial Statements

Under the law on accounting, a company's annual statutory financial statements must be accessible to all interested users. Users can receive copies of annual statutory financial statements upon paying copying costs. The law also requires that certain categories of companies (e.g., open joint-stock companies, insurance companies) publish their statutory financial

statements. They should also submit their statutory financial statements to regional state statistical authorities, in accordance with the company's registration, for further presentation to interested users. The publication procedure for open joint-stock companies requires that balance sheets, income statements, and audit reports be published. Prior to publication, statutory financial statements must be approved by an annual general meeting and audited. Depending on the volume of operations and the size of the company, it may publish a balance sheet and income statement in short form or in full. The deadline for publication is June 1 of the year following the reporting year.

Chart of Accounts

The process of classifying accounting facts in Russia is regulated centrally; a uniform Chart of Accounts created by government authorities is traditionally used. There are three main charts: (i) for commercial (business) companies, (ii) for banks, and (iii) for government-funded nonprofit organizations (universities, hospitals, museums, etc.). The national Chart of Accounts is used, firstly, for working out typical accounting entries, and, secondly, for preparing financial statements. The Chart of Accounts consists of about 60 accounts and 59 subaccounts grouped into 9 main sections. It is from time to time amended. Each account or subaccount can be divided further into analytical accounts according to, e.g., the number of suppliers. On the basis of the Chart of Accounts and instructions to it, an organization should approve a working chart of accounts containing a full list of accounts and subaccounts needed for its accounting purposes.

Introduction of International Financial Reporting Standards

Modern Russian Accounting Rules (RAR) are not yet in line with IFRS, but this is changing. In 1998, the Russian Government adopted a program to reform Russian accounting in accordance with IFRS. Under this program, new RAS are being introduced. These standards regulate major aspects of accounting, as well as the presentation and disclosure of information. The new RAS have introduced fundamental accounting assumptions and requirements, thus bringing Russian practice closer to

international practice. Practical interpretation of the requirements and assumptions under RAR, however, may be different from IFRS (e.g., RAR are often form-driven). In 2004, a new Accounting Development Plan was adopted, outlining fundamental changes to be introduced. The plan calls for the mandatory preparation of consolidated financial statements by public and other public interest companies in accordance with IFRS. Stand-alone accounts will be prepared by companies in accordance with RAR, to be developed on the basis of IFRS. The plan also includes certain measures to develop the accounting profession, in particular, delegating the development of accounting standards to professional organizations, while leaving the state authorities to decide whether or not to adopt them. Under the new law on consolidated financial statements, public companies will prepare their financial statements only under IFRS, whose recognition and translation into Russian will be approved by the government. Consolidated financial statements will be subject to audit and publication. Individuals' financial statements will continue to be prepared based on RAS.

Significant Accounting Differences between Russian Accounting Standards and IFRS

At present, the main differences between RAR and IFRS are:

- The concept of inflation accounting does not exist.
- Consolidated financial statements are treated as secondary to the stand-alone statutory financial statements of a company and are often not prepared.
- There are no rules for accounting for the impairment of certain assets.
- There are no specific rules for business combinations.
- There are no rules for derivative financial instruments, hedge accounting, long-term assets held for disposal, and investment properties.

The major differences between Russian accounting and international practice lies in the understanding of the term “accounting” itself. In Russia, the term has a primary meaning of bookkeeping and a secondary connotation of financial reporting. As a result, RAR give extensive coverage to bookkeeping procedures, rather than financial reporting rules.

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CHAPTER 5

SAUDI ARABIA

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INTRODUCTION

The history of accounting in Saudi Arabia is fairly short compared to that of other developed countries. The early years, until the 1970s, were marked by informal reporting and limited regulations on accounting. A major milestone in the Saudi accounting history was achieved during the 1980s with setting the foundation for accounting thought and uniform practices, under a clear influence of U.S. thinking on the newly established conceptual framework. A more modern profession and financial reporting emerged during the 1990s with the creation of the Saudi Organization for Certified Public Accountants (SOCPA) and the development of generally accepted accounting principles. The demand on financial information expanded with the growth of capital markets during the 2000s, which resulted in improved financial reporting. The interest in the globalization of accounting standards has gained increasing popularity and poses a key challenge facing accounting standard setters going forward. This chapter contributes to the existing limited literature on the history of accounting in Saudi Arabia by reviewing the main phases of this history and highlighting the key milestones achieved during the evolution of accounting and financial reporting, and related regulations.

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EARLY INFLUENCES WITH INFORMAL FINANCIAL REPORTING (C. 1900–1980)

The modern Kingdom of Saudi Arabia was formally founded in 1932, with its origins dating back to the 1740s. The country has a population of 27 million and occupies much of the Arabian Peninsula. It is strategically positioned in the Middle East, with proximity to developed European countries as well as to developing Eastern markets. Saudi Arabia is the largest economy in the Middle East and North Africa (MENA) and is a member of the Group of Twenty (G20) leading economies in the world. The country remains significantly dependent on oil and oil derivatives, where it sits on nearly a quarter of the world's reserves of oil.

Economic activities throughout the first half of the 20th century were carried out by small merchants and entrepreneurs. Traditional trading was the dominant type for most business activities, and was mainly clustered on the western coast of the Kingdom, fueled by the flow of pilgrims to Mecca, as well as on the eastern coast, mostly trading with neighboring Arab countries, as well as with Persia and the Indian subcontinent. No legal formation was considered necessary by most of these small businesses. Merchants and entrepreneurs were mostly running the business themselves and were satisfied with whatever minimal and basic bookkeeping that was available. Most of the accounting records, if existed, were maintained on a single-entry basis (Abdeen & Yavas, 1985; Hassan, 1985).

While the vast majority of business activities in the early years of the Kingdom lacked any formal bookkeeping or financial reporting, there was a small number of businesses that were different and had more modern systems of accounting and reporting, notably, the multinational companies in oil and gas, and banking sectors. One classic example was the California Arabian Standard Oil Company (later renamed the Arabian Oil Company, or Aramco), which was a joint venture formed in the mid-1930s between the Saudi government and the Standard Oil Company of California, and later with Texas Company (now Chevron), to explore oil. The company implemented its own modern reporting system, which was simply a reflection of the developed reporting systems imported from its parent foreign companies. Aramco, which later became Saudi Aramco, remains a private company with no public access to its financial statements, thus limiting the ability to have a better understanding of this important part of the Saudi accounting history.

Branches of Western banks also operated in Saudi Arabia during the first half of the 20th century. The Netherlands Trading Society Bank was the first

bank to run full-fledged operations in the Kingdom. In fact, the Netherlands Trading Society Bank, through its branch, which later became the Saudi Hollandi Bank, acted more than as a typical bank. It performed the role of the central bank for the Kingdom (SHB, 2010). It was the formal channel for collecting the country's main source of revenues, which is oil. It was also handling foreign currency exchanges, especially to serve pilgrims visiting the holy cities of the Kingdom, and later the bank was even requested to establish the first coin currency for the country in 1928. Similarly, the bank relied on the accounting practices and financial reporting systems developed in its country of origin, which were required for internal management reporting.

The mainstream trading businesses did not develop accounting or reporting systems, partly because they were not considered needed by merchants and partly because there were no legal requirements to maintain financial records. This, however, changed in 1931 with the enactment of the first related law under the Commercial Court Act, or what was later referred to as the Commercial Act. This Act set forth, among other things, basic guidelines on how merchants and companies should carry their financial dealings, as well as specific rules for bankruptcy procedures. According to this Act, one of the requirements for financial evidence to be admitted in a court of law was maintaining formal accounting records. The Commercial Act was basically the first law to impose on merchants and companies such requirements, without providing any guidance for accounting treatments. It basically defined the minimum records and ledgers, mainly the general journals, general ledgers, and inventory ledgers, which must be properly maintained so that financial records could be admissible in the case of litigation. It even went further with more restrictive formalities, such as maintaining general ledgers with pages prenumbered and notarized by the court. These conditions were relaxed over subsequent years, either formally or by mere practices. These guidelines were later taken out in 1989 to a separate code titled the Financial Records Law. Compliance with such regulations, however, was eased with the exemption of businesses with a capital below 100,000 riyals (US\$ 27,000). While the exemption at this minimum capital relieved a large number of businesses, the significance of such a law was the establishment of a benchmark for business practices that surely influenced how businesses carried their accounting systems.

The Rise of Regulations

A significant growth in business activities took place in Saudi Arabia during the 1960s and 1970s, driven largely by the boom in oil prices. More

businesses had become larger and relatively more advanced. There was also a big increase in the number of international companies operating in the Kingdom. With such growth, local businesses started to move toward formalizing their operations away from the sole merchant format and more toward legal establishments, partnerships, and limited liability companies. As their businesses continued to grow, sole merchants started to expand ownership and join others within and outside of their families. Single ownership with no formal legal structure has become a less dominant form for businesses with significant size. With the increase in ownership participation, there was a gradual separation between ownership and management (Yapa & Wijewardena, 1995), which raised more demand on better accounting and financial reporting systems.

In line with the growth in business activities and changes in the legal forms of how businesses operated, more regulations were required to support such a shift. The Companies Act of 1965 was the first comprehensive law to collaborate previous regulations and various ministerial circulars in a more rigorous form. This Act defined in more details the formal aspects and requirements of the emerging legal forms of doing business. Under this Act, companies also became required for the first time to issue formal financial statements on an annual basis. Such requirements were imposed on various legal forms, including joint-stock companies, partnerships, and limited liability companies. The preparation of the balance sheet and profit and loss statement at the end of each fiscal year became a standard requirement. This Act was indeed another significant step forward in the Saudi history of financial reporting and marked the first reporting requirement in the Kingdom, though with limited guidance provided on the content or format of such reporting. The Act merely required that balance sheet and profit and loss statement be classified. It also imposed the requirement of consistency when valuing balance sheet items from one year to another, without further guidelines.

Another milestone in the history of financial reporting in Saudi Arabia was the requirement under the Companies Act of 1965 to audit financial statements by external auditors. This included joint-stock companies and limited liability companies. This was the first time public accountants were formally recognized and empowered by the law. This was a critical development, as it had given rise to a formal profession of accountancy in the Kingdom, and accountants became an essential component of the business environment. The Banking Act issued a year later in 1966 also imposed on banks the requirement of being coaudited by two external auditors.

The Companies Act of 1965 provided limited elaboration on who would qualify to be a public accountant. This, however, was addressed in a more detailed regulation three years later through a ministerial resolution issued by the Ministry of Commerce and Industry (MOCI) in 1968 that outlined certain requirements for practicing audit in the Kingdom. Those guidelines were later replaced with the more authoritative and detailed Certified Public Accountants Act of 1974, which came out as a reflection of the increasing significance of this growing profession. The CPA Act outlined minimum qualifications for those practicing the audit, the scope and responsibilities of their work, and their required compliance. This Act also provided for the creation of a "higher committee" to oversee the accounting profession, but effectively it was mainly responsible for licensing accounting firms and accounting professionals.

Diverse Influences

Accounting practices in Saudi Arabia during early years until the 1970s were mainly inconsistent and lacked uniformity. This was mostly due to the lack of unified guidelines on accounting thought, with no established generally accepted accounting principles in the Kingdom. In addition, the demand for accounting and reporting was mostly driven by internal demand, that is, management accounting and reporting, rather than by external demand, that is, financial accounting and reporting. This was despite the legal requirements to issue financial statements, which were not strongly enforced by regulators. Further, external reporting was effectively limited to meeting reporting requirements by lending banks, as well as the important Saudi Industrial Development Fund, which extended subordinated loans to support business growth, especially during this period. Accounting practices were quite inconsistent and were left for companies and their auditors to decide, as there were no formal guidelines to follow, or restrictions to impose.

Various practices surfaced as a result of the different needs and backgrounds of businesses. Accounting practices and financial reporting were largely influenced by various choices made by the multinational companies, the international accounting firms, and the diverse backgrounds of the dominant expatriate accountants working in Saudi Arabia (Yapa & Wijewardena, 1995). As a result of such diverse influences, no unique accounting system could be detected in Saudi Arabia at that time, unlike the case in other developing countries impacted by colonial powers, for

instance, where the French accounting system in several North African countries and the British accounting system in India and Pakistan could be easily detected (Enthoven, 1983).

The diverse background of large multinational companies and financial institutions, coming mostly from the United States and different parts of Europe, resulted in diverse accounting systems and practices in Saudi Arabia. The multinational companies in the oil and gas and banking sectors, which represented the main two economic activities in Saudi Arabia, operated under relatively more advanced corporate form and ran their own individual accounting and reporting systems for their management reporting and for consolidation with their parent companies. They did not have to be influenced by any local standards and practices or compliance requirements, simply because almost none existed. At the same time, it could be argued that the established practices of such institutions had limited influence on mainstream businesses, basically for the lack of public disclosures on one hand and for the lack of interest by mainstream businesses to develop their accounting and reporting practices on the other hand.

The number of local accounting professionals was indeed limited where only 70 public accountants were licensed by 1968 (Shinawi & Crum, 1971). With the limited number of reputed local audit firms, the international accounting firms were responsible for auditing multinational companies and had clear influence over their accounting systems (Gress, 1985). In addition, the limited number of local accounting professionals created dependency on expatriate accountants coming from various countries, mostly from neighboring Arab countries, Pakistan, and India. The lack of local guidelines on accounting practices had led to various and inconsistent treatments by the individual accountants coming from different accounting backgrounds, influencing mostly the smaller, local businesses.

The Demand for Accounting Education

The acceleration of business activities and the legal empowerment of public accountants led to a growing interest in the accounting profession. With the limited resources of human capital specialized in accounting, especially among Saudi nationals, there was a pressing need for more supply of accounting professionals, considering the high momentum in business activities (Shinawi & Crum, 1971). Gradually, Saudi universities started to offer formal training and undergraduate degrees in accounting and related

disciplines to fill such a gap. King Saud University introduced in 1957 the first formal accounting education program in Saudi Arabia. This was followed by similar programs offered by the University of Petroleum and Minerals in 1964, King Abdulaziz University in 1971, and King Faisal University in 1974. In 1980, the Saudi Accounting Association was also established by King Saudi University to promote accounting education and accounting research. It has held a series of conferences on developing the accounting profession and accounting education in the Kingdom and participated in the publication of several textbooks and scholarly research. As a result of this new focus on accounting education, there was a significant increase in the number of accountants in Saudi Arabia during the 1980s in line with the growth in businesses and the increase in accounting programs (Merei, 1985).

The Limited Role of Zakat and Taxation

The first regulation of zakat and taxes can be traced to the 1950 Zakat and Income Tax Act. Zakat is a tax-like duty based on Islamic laws and levied on all Saudi companies, in lieu of the traditional income taxes, to be paid ultimately to the needy. Zakat is calculated based on the net worth of the company, rather than focusing solely on its income. One of the provisions of the zakat and tax regulation was that it imposed further requirements on businesses to maintain proper accounting books as part of their filing with the Department of Zakat and Income Taxes. Failing to meet this requirement would subject the business to presumptive zakat and tax liabilities based on deemed profitability. Unlike the case of the previous provisions of the Commercial Act of 1930, which required maintaining bookkeeping so that financial records could be admissible in the case of litigation, the significance of the Zakat and Income Tax Act was that it imposed maintaining proper financial records as an essential part of doing business and compliance in the Kingdom. It also enhanced the recognition of external auditor later by accepting financial statements as a reliable source for assessing zakat and tax liabilities as long as they were certified by external auditors.

The review of accounting history, in general, demonstrates the important impact of taxation on accounting practices in many Western societies. The case is quite different, however, in Saudi Arabia where zakat and tax regulations had insignificant impact on accounting practices. There is a limited divergence between taxation and financial reporting, mainly relating

to the treatments of depreciation, unrealized items, and provisions. The zakat and tax systems are relatively very simple and straightforward, as they have not been influenced by the various socioeconomic factors influencing tax systems in other societies, and contributing to their complexities. This has led to limited impact of tax regulations on accounting practices in Saudi Arabia.

BUILDING THE FOUNDATION FOR FINANCIAL REPORTING (C. 1980–1990)

Throughout the 1960s and 1970s, regulators focused mainly on establishing the financial reporting as a standard business requirement and enhancing the reliability of such information through the certification requirements by the public accountants. To ensure that such a certification process was indeed working led to further regulations focusing on accounting professionals. Limited effort, however, had been devoted to establishing the content and format of such financial reporting, let alone the underlying accounting thought and principles driving such reporting. The main focus of regulators was first on the messenger and later on the message itself. During the late 1970s, it was about time that the focus be shifted rightly to the development of a more established accounting and financial reporting environment.

With the growth in business activities and demand for more reliable financial information, there was a growing concern over the lack of a well-established accounting and financial reporting in the Kingdom. The significance of such concerns arose from the context of a countrywide campaign during this era to strengthen the role of the private sector in the Kingdom as part of the plan to diversify the Saudi economy and reduce its dependency on oil revenues, which showed high volatility during the 1970s with significant impact on the economy. It was argued that some users of financial statements were quite hesitant to rely fully on financial information as a result of the uncertainty surrounding the accuracy of such information and the consistency of how it was prepared (MOCI, 1985).

The aspiration to develop the accounting profession in Saudi Arabia was self-motivated by accounting professionals and regulators and was driven by economic need, rather than as a reaction to scandals or lack of confidence resulting from financial crises as in other countries. There was some concern by professionals that the accounting profession might have fallen short of

where it should be and as to the role it ought to play in the growing business environment. Accounting professionals were preemptive and brought such concerns to the MOCI and discussed how to take the profession to the next level, and ensure that current financial reporting would keep pace with the growth in business demand for financial information. A survey was conducted in 1979 to assess accounting and reporting practices in the Kingdom (SOCPA, 2000). This preliminary review identified a significant shortfall in the prevailing accounting practices, and it proposed certain recommendations to the MOCI on steps required to develop the accounting profession in the Kingdom.

The Development Project

Based on the outcome of the preliminary survey conducted by accounting professionals, the MOCI initiated in 1980 a multiyear project (the Development Project) to address the development of the accounting profession, including accounting and financial reporting. The mandate was to develop accounting and financial reporting in a way that would take the existing informal, inconsistent local practices to a more advanced level that would encompass best practices in the developed countries.

The project to develop accounting and financial reporting was the collaboration of effort between the government through the MOCI, who sponsored this project, and the private sector through academics and professionals who, in reality, drove this project. The Development Project team was led by Abdulaziz Al Rashid and comprised of many local and international experts, including Abdullah Al Faisal, Abdulrahman Al Humayed, Abdullah Al Muneef, and Yusef Al Mubarak, who later was appointed as the first secretary general of SOCPA. The great contribution of those individuals who set the right foundation for the development of the accounting profession in the Kingdom should be duly recognized.

The composition of the Development Project team was carefully made to ensure that both local expertise (whether in academia or in the profession) and international expertise were properly represented. This composition had led with no doubt to the successful outcome of this project. The fact that neither academics nor practitioners were to work alone ensured that theory would be validated and scrutinized by practical implementation. Equally important, leveraging on international capabilities, including former board members of the American Institute of Certified Public Accountants (AICPA), the Institute of Chartered Accountants of Scotland,

and international accounting firms, had helped accelerate the progress of the project and expose the thinking and recommendations to the successes and challenges encountered in other parts of the developed world.

Having established a preliminary assessment of existing practices in Saudi Arabia, the first objective of the Development Project was naturally to review the accounting profession in different parts of the developed world. The goal was simply to start where others had ended. However, to ensure the practicality of future recommendations and implementations, it was decided to expand the scope of examination to include the experiences of different countries that were at different stages in their development of accounting. Nine countries were shortlisted for this review and clustered in three groups: the first group included the United States, the United Kingdom, and Canada, representing countries with the most advanced accounting practices and accounting profession. The second group included Tunisia, Venezuela, and Brazil, representing developing economies with experiences that could, in certain aspects, be more relevant to Saudi Arabia in terms of execution. The third group included France, (West) Germany, and Sweden and basically represented a midpoint between the former two groups in terms of the development of the accounting profession. Based on the review of these nine countries and the decision to choose one country from each group, the United States, Germany, and Tunisia were selected to constitute the scope of study, where a roadmap was to be laid out as to how to develop the accounting profession in Saudi Arabia based on the experiences of the selected countries. A detailed study was conducted in 1980–1981 during the first phase of the project to basically identify the status of the accounting profession in the three selected countries, how they had reached there, and what was needed back home to reach similar successes.

Based on the outcome of its comparative review of the accounting profession in different countries, the first phase of the Development Project identified four key components that were deemed essential in order to build the foundation and bring significant development to the accounting profession in the Kingdom. These areas included: first, establishing a conceptual framework for accounting, defining the objectives of financial statements and its key concepts, and covering accounting recognition and measurement of common topics; second, outlining key information to be reflected in financial reporting through the issuance of a standard on the presentation and disclosure of financial statements; third, issuing formal auditing standards; and fourth, preparing a vision and recommending bylaws for the independent professional organization to be responsible for developing the accounting profession going forward (SOCPA, 2000).

Developing the Conceptual Framework of Financial Accounting

The second phase of the Development Project began in 1982 to work in parallel in the four key components identified during the first phase, as mentioned earlier. One clear and critical gap in the accounting profession was the lack of any coherent conceptual framework of accounting thought and financial reporting in Saudi Arabia. Therefore, any effort to develop the accounting profession could not be considered complete without first filling this gap and building the foundation for the development of accounting thought.

The Companies Act of 1965 did not provide formal guidance on accounting treatments, and there was neither public nor private organization to issue accounting standards. The first and most pressing task for the Development Project team was to establish a proper conceptual framework that would be the basis for issuing accounting standards. This framework was basically expected to define clear objectives of financial accounting and provide clear definitions of the basic elements of financial statements to bring uniformity and ensure the consistency of issued accounting standards going forward. Fortunately, during the period that this project was underway in the 1980s, the accounting thought, in general and not in Saudi Arabia per se, had been formulated to a great extent. Therefore, it could be imagined that intellectual debates among the Development Project members on establishing accounting thought and treatments would have been much more challenging had such discussions taken place a couple of decades earlier.

The Statement on Financial Objectives (SFO) was prepared by the Development Project team to set forth the expectations of what financial statements can and cannot provide. It defined the key external users that financial statements were intended to serve, including investors, creditors, suppliers, and customers. It then highlighted the common information needs of each category of external users and the kind of information that can be produced by financial accounting, regardless of the legal form or the underlying nature of business activities. Based on that, the SFO defined the major objectives of financial statements, including providing information to satisfy the needs of major users, the periodic measurement of income, assisting users assess the ability of the firm to generate cash, measuring its assets and liabilities, and assessing its sources and applications of funds. The SFO clearly identified certain limitations of using financial statements, such as the fact that information provided is not readily useful for specific purposes, and might require further modification to calculate taxes, for

example, or determine the fair value at the time of liquidation. The SFO specified financial statements to include the balance sheet, the income statement, and the statement of sources and application of funds. The SFO was the first to introduce the cash flow reporting, which was not required under the Companies Act of 1965, as part of the standard set of financial statements.

The second part of the conceptual framework of financial accounting related to the Statement on Financial Accounting Concepts (SFAC). It defined the basic elements of financial statements, including assets, liabilities, owners' equity, revenues, expenses, gains and losses, net income, and owners' investments and distributions. The SFAC outlined key concepts of accounting measurement, including the accounting unit, going concern, periodic reporting, unit of measurement, basis of measurement, and matching. Finally, the SFAC set forth the key concepts of qualitative accounting information, including relevance, reliability, objectivity, comparability, timeliness, understandability, and materiality, and it outlined the required disclosures of the basic elements in the financial statements.

Developing the draft for the first Saudi accounting standard was part of the objectives set in the second phase of the Development Project. The Standard of General Presentation and Disclosure was developed to cover the general presentation requirements, treatments of accounting changes and contingent gains or losses, and the minimum required disclosures for general purpose financial statements, as well as for consolidated financial statements. This Standard expanded the set of financial statements to include the balance sheet and income statement, as required by the Companies Act, and the statement of sources and application of funds, as introduced by the SFO, and the statement of changes in owners' equity. It also imposed that notes and disclosures become part of the minimum requirement of financial statements. This Standard also included illustrative forms and general guidelines for the preparation of financial statements, which were very important to standardize the format of financial reporting, although such formats were not intended to be mandatory.

The development of auditing standards was also part of the scope of the Development Project during its second phase. The lack of formal auditing standards was a shortcoming not sufficiently addressed in the issued regulations. Based on the review of essential audit standards in other countries, the team developed a set of audit standards that should be adhered to when conducting audit work in the Kingdom. These standards addressed key areas and principles, including auditor qualifications, objectivity, due care, planning, control, and evidence. The standards also

addressed the content of the audit reports, which was one important area where no clear guidelines were available at that time.

The statements on financial objectives and concepts and the standard of general presentation and disclosure constituted the first set of developed accounting thought in Saudi Arabia, and represented indeed a qualitative shift in the accounting history of Saudi Arabia. This newly developed conceptual framework of accounting was intended to develop one coherent foundation that would become the reference for accounting practices in Saudi Arabia and would serve as the basis for issuing proper and consistent financial accounting standards going forward. When examining this foundation, the influence of U.S. thinking on Saudi accounting thought and practices could be clearly detected. There was a natural bias toward the accounting thought as established in the United States, considering the selection of countries made during the first phase of the project, as well as the composition of the Development Project teams with U.S. expertise and U.S.-educated members. This does not take away, of course, from the fact that the advanced level of development of accounting profession in the United States lent itself to such a natural influence and that the U.S. influence during the 1970s was dominant across different parts of the world. Further, the U.S. influence was evident not only through the way the foundation was built or how the conceptual framework was formulated, but also through the more formal reference issued later by the Saudi standard setters to rely on U.S. GAAP as an authoritative source for guidance in case the Saudi GAAP fell short of addressing the treatment of any given topic.

The recommendation reports were presented by the Development Project team to the regulators, academics, and practitioners, which were subject to debate and discussions. The MOCI endorsed the reports in 1985, and the newly developed financial accounting conceptual framework and the standard of general presentation and disclosure became officially an acceptable, although still nonbinding, reference to be used by companies and to be followed by all public accountants when auditing financial statements in Saudi Arabia. The rationale for this nonbinding nature was to put this new conceptual framework under examination for a number of years and be subjected to further scrutiny through actual practices and implementations. In 1990, the MOCI finally imposed the compliance with the financial accounting conceptual framework and the standard of general presentation and disclosure, which became the authoritative reference for accounting practices at that time. All public accountants in Saudi Arabia became required to comply with this framework. This historical development marked the creation of the first set of the Saudi GAAP and the roots for uniformity and consistency in accounting practices.

THE BIRTH OF A MODERN ACCOUNTING PROFESSION (C. 1990–2000)

One of the key findings that came out of the Development Project during the first diagnostic phase was the lack of a special body dedicated to develop, support, and regulate the accounting profession in the Kingdom, similar to other countries. It was argued that subsequent developments to take the profession to the level that it was expected to be would require more than the work of a series of ad hoc projects. It would require a more permanent setup empowered with the legal support and the required expertise from all stakeholders, including regulators, academics, practitioners, and the private sector. To come up with plausible recommendations, the Development Project reviewed the structuring of standard setters and professional organizations in the United States, Germany, and Tunisia. The recommendations took into consideration the current status of where the profession was in Saudi Arabia and the existing level of development in accounting thought, as well as the audit practices during such an era. That is, what might be perceived as best practices in a country like the United States might be considered less practical or too ambitious to envision being implemented in the Kingdom at that time. In addition to the organizational structure, the existing regulations mandated by the CPA Act of 1974 were also reviewed to accommodate the proposed changes in the regulations of the profession based on the best practices of other countries. The recommendations were presented to the MOCI to establish an independent professional organization to be responsible for setting accounting and auditing standards, and developing the accounting profession in general. The recommendations included the organizational structure, along with a proposed set of bylaws for the organization.

All the immense effort made throughout the Development Project paid off indeed with the historical enactment of the new CPA Act in 1991, which repealed the previous CPA Act of 1974. This major milestone in the accounting history of Saudi Arabia marked the birth of SOCPA, as promulgated by the new CPA Act. While great success was achieved when the conceptual framework was endorsed and later become mandatory, the significance of this milestone, in particular, was ensuring the continuity of the development process of accounting and financial reporting going forward. This was achieved through the recognition of a dedicated and independent professional organization responsible for developing and regulating the accounting profession and CPAs. The Act delegates to SOCPA the process of reviewing, developing, and approving accounting and auditing standards. The MOCI would oversee this organization to

ensure it achieves its objectives. The Act also requires all CPAs working in the Kingdom to comply with SOCPA's standards, rules, and regulations.

The Saudi Organization for Certified Public Accountants

SOCPA was established in 1991 with the main objectives of reviewing and developing accounting and auditing standards. It is also entrusted to establish and promote the accounting profession and the CPA certification and related training and continuing education programs. It also regulates public accounting firms and establishes their required compliance and quality review programs. SOCPA combined within its responsibilities the role of accounting standard setters, similar to that of the Financial Accounting Standards Board (FASB) or the International Accounting Standards Board (IASB), and the role of professional regulators, similar to that of the AICPA. While this dual role would be considered less preferred in developed environments such as the United States, it was certainly prudent to start somewhere, considering what could realistically work given available resources and existing challenges. This would be acceptable as long as it ensured the development process was initiated and structured on an ongoing basis.

SOCPA is run through a board of directors comprised of 13 part-time members. The board is chaired by the Minister of Commerce and includes four representatives of related government and semigovernment agencies, two academics, and six certified public accountants to be elected by the organization's general assembly. SOCPA is run as an independent organization, and its financing depends mostly on subscriptions, government subsidies, and donations. Administrative work is carried out through the SOCPA's secretarial general, but technical matters are carried out through multiple permanent technical committees. Key committees include the Accounting Standards Committee, Auditing Standards Committee, Professional Ethics Committee, Examinations Committee, Quality Review Committee, and Education and Training Committee. Additional committees were introduced later including the Public Relations and Media Committee, Internal Audit Committee, Advisory Services Committee, and Professional Accountants in Business Committee.

The Creation of Saudi GAAP

The Accounting Standards Committee is responsible for the development of accounting standards in Saudi Arabia and for the issuance of interpretations and technical opinions. The Committee implements a transparent due

process for the issuance of new standards. This process is based on a public review and debate of all proposed new standards and goes through multiple phases until a standard is finally approved. This committee consists of 13 part-time members representing all stakeholders, with 4 members selected from the profession, 4 members from academia, 2 members from the government, and 3 members from the private sector.

Filling the gap in the set of generally accepted accounting principles in Saudi Arabia was a key objective for SOCPA. At the time SOCPA was established, there was simply one formal Saudi accounting standard, which is the standard of general presentation and disclosure, in addition to the developed conceptual framework covering the objectives of financial accounting and its key concepts, along with key measurement and recognition guidelines. With the Saudi accounting profession taking a more formal route for development through SOCPA, there was a clear priority to develop key standards that would constitute a formal set of Saudi generally accepted accounting principles. This would become a natural requirement for bringing the accounting practices in Saudi Arabia to a more developed and consistent form.

During the last two decades, SOCPA has issued 21 accounting standards and several professional opinions. The process of preparing new standards was rather pragmatic. It was less of insisting on developing new thinking in accounting thought and problems, and more of a process of adopting, building on, and making some customization and localization of the products developed in other countries. Priority was given to streamline accounting practices in common topics which were considered less controversial. The preparation of new standards followed a defined methodology where any proposed standard, once prepared, must be compared with already established accounting standards in at least three regions. The countries selected typically included the United States, the United Kingdom, and the international accounting standards (IAS). Clearly there were few topics with their uniqueness to Saudi Arabia, which had to be developed internally. One example relates to the measurement, presentation, and disclosure of zakat in financial statements, where no similar experiences could be found in other countries.

The IFRS Influence

With the evolution of the International Financial Accounting Standards (IFRS) and its growing popularity across many parts of the world, especially

during the 2000s, the U.S. GAAP was no longer considered by some of the local stakeholders the undisputedly main source of best practices to be followed. The compelling notion of one set of accounting standards to be followed all over the world, and the misperception that would somehow end many inconsistencies in accounting practices, has fueled more enthusiasm among regulators and practitioners in the discussion of harmonization with the IFRS.

A turning point in the accounting practices in the Kingdom took place in 2002 when SOCPA made a decision that the IFRS should be referred to as an authoritative source for guidance on accounting treatments that are not covered by Saudi GAAP (SOCPA, 2002). This decision replaced a prior one by accounting standard setters allowing the reliance on U.S. GAAP under such circumstances. The significance of this decision comes from the fact that until that time, Saudi accounting standards, including the conceptual framework, were greatly influenced by the U.S. GAAP. This decision sent an early signal of the Kingdom's interest to become part of this global initiative. Historically, Saudi accounting standards tended to be very similar to the U.S. GAAP until more recently when the influence of the IFRS on newly issued standards has become more evident. Although the change in direction has been in effect since 2002, its influence on new standards was clear only during the last few years.

The change in the mindset of standard setters toward the IFRS has impacted to some extent the coherence and consistency of existing Saudi accounting standards in recent years. As highlighted earlier, Saudi standards had been built on the foundation of a conceptual framework that was consistent with U.S. GAAP. However, some of the newly issued standards, as influenced by the IFRS, would not necessarily fall within the same thinking framework of conservatism, rule-based, and having fewer options and more detailed philosophies, among others, that dictated prior standards, in line with U.S. GAAP. One example relates to the issue of fair valuation of nonfinancial assets. A relatively new standard on the impairment of long-term assets issued in 2007 allows the upward revaluation of assets that were previously impaired, in line with the IFRS treatment, whereas other standards, for example, fixed assets, and their underlying conceptual framework, do not entertain such an option. Another case relates to the treatment of investment in properties, which is a topic not covered by Saudi standards yet, and therefore the IFRS should be referred to in such a case. While the IFRS allows valuing investments in properties either at cost or at fair value, SOCPA responded to public confusion on this topic by issuing an opinion disallowing the use of fair value in measuring

investments in properties. It was argued that the use of fair value would contradict with the existing conceptual framework and previous regulations issued by the MOCI prohibiting marking up to market the value of land. A similar contradiction was evident in the case of biological asset valuation, which is another topic not covered by Saudi GAAP. One public dairy company followed the IFRS in the valuation of its herd using fair value, which led SOCPA to take a similar stand and disallow the reference to the IFRS in terms of valuing biological assets at fair value. There are clearly some challenges during this shift in thinking, and this has created some inconsistencies in accounting treatments, as a result.

THE INFLUENCE OF MULTIPLE REGULATORS AND THE GROWING DEMAND ON FINANCIAL INFORMATION (C. 2000–PRESENT)

One of the challenges facing the accounting profession in the more recent part of the accounting evolution in Saudi Arabia is the fact that there have been multiple regulators of financial reporting in addition to SOCPA, including the MOCI, the central bank, and the regulator of capital markets. The CPA Act of 1991 has established a formal link between the MOCI and SOCPA, and one important motivation for this was basically to empower SOCPA through its association with the MOCI and ensure compliance of companies as well as CPAs. This was especially important during such a time, when the concept of accounting regulations was almost nonexistent. The jurisdiction of the MOCI covers companies across almost all sectors, with the main exception of the banking and, more recently, the insurance sectors. These two sectors are regulated directly by the central bank.

The Influence of the Central Bank

The Saudi Arabian Monetary Agency (SAMA) was founded in 1952 to assume the function of the central bank of Saudi Arabia, and has played since then a significant role in the development of the Saudi banking system to cope with best international standards. This was evident during the recent financial crash of 2008, when Saudi banks came out of the crisis with limited impact due in part to the close monitoring and conservative requirements imposed by SAMA.

The scope of issued accounting standards in the Kingdom naturally did not cover specialized standards on banking transactions. SAMA identified this gap and issued a set of accounting standards in the early 1990s related to banking topics, which all banks operating in the Kingdom were required to comply with. Banks were requested to use standards issued by the MOCI (i.e., SOCPA standards) for topics not covered by SAMA standards. This was effectively the first time that a body other than SOCPA was to regulate accounting treatment ever since the enactment of the CPA Act of 1991. Nevertheless, banks, for many years, had expressed resistance to comply with the requirement of applying local standards whether issued by SAMA or SOCPA and, hence, there was no consistency in the accounting standards applied by banks (Al Humayed, 2009). The argument was that following local standards would make it difficult for banks, where most of them were co-owned by international banks, to run dual reporting systems and meet the consolidation requirements of their parent companies. It was also argued that they would still need to produce financial statements acceptable by the international banks that they transact with. SAMA was mindful of such challenges and did not impose pressure on banks for the compliance with local standards.

The central bank of Saudi Arabia has always inspired to develop Saudi banks to the best standards. For SAMA, it was very important to ensure full compliance with international banking standards, such as those issued by the Basel Committee on Core Principles of Effective Banking Supervision, in order to have a rigorous and advanced banking system. Part of that ambition, the use of IAS was deemed essential so that Saudi banks could be in line with the international best practices and could meet international rating standards. This thinking was clearly influenced by the pressure from banks who had always advocated the use of international standards and preferred not to use any local standards. This pressure was more vocal through the SAMA's Chief Financial Officers Committee (CFO Committee), which includes CFOs from all banks. Since the early 2000s, the CFO Committee has debated and unified banks' views on preferred accounting treatments and disclosure requirements, especially when new standards were issued. Such views were to be endorsed by SAMA, which must clear all financial statements of banks prior to their issuance. Accordingly, SAMA started to require that banks issue their financial statements in accordance with IAS. SAMA issued, for instance, a new regulation in 2001 requiring banks to follow IAS 39 and later requiring all banks operating in Saudi Arabia to prepare their financial statements based on the IFRS.

The use of IASs by Saudi banks was strongly challenged by SOCPA, since this clearly violated the provisions of the CPA Act of 1991, which stipulates

that the accounting standards issued by SOCPA should be followed in Saudi Arabia. The key argument behind such a critical decision by SAMA to follow international standards was that Saudi GAAP, as issued by SOCPA, was not complete since there was a gap of issued standards on banking, financial derivatives, and similar topics that were essential to banks. SAMA claimed that this shortfall might lead to inconsistency and inaccuracy in the preparation of financial statements. The contest by SOCPA was unsuccessful, and the compromise reached after this debate was that SAMA would revoke its decision and revert back to SOCPA standards as soon as they would become complete. Of course, this was too vague and a difficult target to measure.

While the argument of incompleteness of the Saudi GAAP was valid, it was certainly overstated, and could not have been the main reason for taking such a serious decision to abandon the use of local GAAP by Saudi banks. As mentioned earlier, the concerns over the incompleteness of standards were addressed by SOCPA through its reference initially to the U.S. GAAP and later to the IFRS as an authoritative source for guidance on topics not covered by local standards. Two factors, however, might have also contributed to such a critical decision by SAMA. First, there was a strong appeal of the "international standards" concept to regulators and politicians as this term is always associated with the perception of high quality and best practices. Of course, this is true in various applications of this term but not necessarily in the case of accounting standards. The notion of international recognition was somewhat mixed with the notion of high quality, which was as argued by SAMA and banks who have advocated the use of IFRS.

It could be speculated that another reason behind SAMA's decision to require the use of the IFRS by banks and insurance companies relates to the notion that SOCPA and its standards were somehow "guilty" by their perceived association with the MOCI. There was a natural competition of jurisdiction between the two regulators, SAMA and the MOCI, where the topic of accounting standards seems to have been caught up in the middle. SAMA viewed SOCPA to be part of the MOCI, and SAMA therefore was not obligated to follow the mandates of a different regulator, the MOCI. One example of this rivalry manifested itself when SOCPA required all CPAs to audit banks and issue financial statements based on the Saudi GAAP as issued by SOCPA, in line with the provisions of the CPA Act. Financial statements based on the IFRS, as required by SAMA, would then become supplementary and be prepared as special purpose financial statements. CPAs violating such mandates would be subject to

suspension. Leveraging on SAMA's power and its links to the influential Ministry of Finance, this decision was never enforced. A more recent standoff occurred when the same problem resurfaced with regard to the audit of financial statements of insurance companies, which were required by SAMA to be issued in accordance with the IFRS. A compromise was reached when external auditors were required to issue "other than unqualified" opinions or opinions with "emphasis of matter" in their audit reports on such financial statements for not being prepared in accordance with SOCPA standards, although differences were found to be mostly insignificant.

The Development of Capital Markets

The origins of capital markets in Saudi Arabia could be traced to the mid-1930s with the establishment of the first Saudi joint-stock company, the Arab Automobile Company (Jazira, 2010). Such markets, however, were largely unregulated and marked by informal and very illiquid trading through unofficial brokers. For decades, capital markets remained undeveloped and were limited to a small number of equity issuances, with the majority of which were owned by the government. There simply were no pressing requirements for this channel of financing where the big bulk of businesses were in the form of family-owned entities that were dependent on self-financing with the support of the emerging banking sector and government development funds.

During the 1970s and 1980s, the Saudi economy was undergoing a major reform to encourage the participation of the private sector in the economy and reduce its dependence on the government. To facilitate such directions, there were calls for supporting the private sector with a better access to capital markets. The government responded in 1984 with the formation of a special ministerial committee comprising the MOCI, the Ministry of Finance, and the central bank, SAMA. The mandate of this committee was to draw a roadmap for the development of a modern capital market in Saudi Arabia and to promote trading. The equity markets were subsequently developed and regulated by the SAMA. Trading was automated in 1991 and further enhanced with the creation of the Saudi stock exchange (Tadawul) in 2001 as a company separate from the central bank, yet remaining under its direct supervision.

The interest of investors in equity markets expanded during the 2000s with the flow of capital in equity markets and extended investor base. With the increasing number of initial public offerings, the size of the Saudi capital

market has increased over the years to become the largest market in the MENA region with a market capitalization reaching US\$ 500 billion. As a result, the demand on financial reporting by investors increased, and their investment decisions were influenced by accounting information (Al Sehali & Spear, 2004; Al Tahhan, 2000), although the focus remained mostly on basic financial information (Al Razeen & Karbhari, 2004). This is in contrast to results of research done on prior periods, which found no significant impact of the announcement of financial information on investor decisions (Abdelsalam & Satin, 1988). Trading was dominated by individual investors where their reliance on fundamental analysis based on financial information when making investment decisions did not always come first. Casual trading based on technical analysis was the key driver for investment decisions for most investors during the market bubble between 2004 and 2006, with an apparent disconnect between market prices and accounting information, as reflected by record high-valuation multiples, reaching close to 40 times price-to-earnings ratios for the market.

A major milestone in the development of the Saudi capital markets was achieved with the establishment of the Capital Market Authority (CMA) under the Capital Market Act of 2003. This Securities and Exchange Commission (SEC)-like organization started to regulate the capital markets and took over such responsibility from the central bank in 2004 with the formation of its first board. Obviously, the CMA could be considered as another regulator of financial reporting with its jurisdiction over public companies, creating a potential overlap with the other regulators. The CMA, however, has not been involved in setting any accounting standards or imposing different financial reporting requirements. In fact, it has required that public companies prepare their financial statements in accordance with SOCPA standards (CMA, 2004).

One key matter that occupied the CMA during its first years was dealing with the growing number of IPO issuances that took place during the market rally until 2006. After the market bubble burst in February 2006, the investor sentiment toward equity markets took a major turn, when a great number of investors, especially small investors, suffered from significant losses with the market index falling by more than 60%. There was a need to restore confidence in the markets, starting from stricter regulations and enforcement on insider trading and emphasis on corporate governance to the introduction of less risky investment products such as bonds into the capital markets, which continues to be dominated by equity. The CMA also launched a wide campaign to increase investor awareness of the important role of financial information in making investment decisions.

The growing significance of equity markets as a means to access capital has led to more discipline in financial reporting by public companies. One of the main activities of the CMA is the supervision of the disclosure and compliance with financial reporting by listed companies. This has resulted in more disciplined financial reporting. It was found, for example, that the timeliness of financial reporting by public companies had improved after the CMA's involvement (Al Jabr, 2007). Similar results were found about the improved earnings quality after the establishment of the CMA (Al Aqeel, 2011). The investor demand on financial information developed further with the significant increase in the number of individual investors, which increased, for instance, from less than 40,000 in early 2000 to more than 4 million in 2006, as well as institutional investors (CMA, 2009). More demand was driven by the participation of more institutional investors, such as mutual funds and investment banks, in the markets, as well as the recent opening of markets to international investors in 2008, after they had been limited to investments through mutual funds since 1997. The role of the CMA has been very instrumental in the enforcement of financial reporting. A major task was to ensure that SOCPA standards are being properly followed by listed companies and that transparency is adhered to. With the closer scrutiny by the CMA and the different dynamics and pressure of public companies, more accounting and reporting issues have surfaced and have been referred to SOCPA for clarification. This has certainly pushed for quicker actions and involvement in formalizing certain accounting treatments which were not part of the established Saudi GAAP. With the growth of capital markets, the significance of financial reporting has clearly increased and become an important component of investment decisions. This shift has also expanded the spectrum of users effectively utilizing financial statements beyond the traditional banks, development funds, and the government, who had been the main external users of financial statements for decades (Merei, 1985).

Influence on Neighboring Countries: Toward GCC GAAP

The accounting profession in Saudi Arabia, it could be argued, is one of the most advanced accounting professions in the regional Arab countries as measured by the structure of the profession and the required infrastructure in terms of establishing local accounting and auditing standards, supervision of the profession, and its related certification, development, and monitoring. This view was in fact confirmed by the International Federation of

Accountants (IFAC), which has stated that the SOCPA's "well-established professional accountancy body with highly skilled and experienced staff and members" could be a valuable resource for the development of other countries, especially in the Arab world (IFAC, 2007). The success achieved in Saudi Arabia has led to similar interest to develop the accounting profession in the neighboring countries of the Gulf Cooperation Council (GCC), which includes Kuwait, Bahrain, United Arab Emirates, Qatar, Oman, and Saudi Arabia. The GCC forum has been established for three decades with the aspiration of establishing an economic zone, in addition to unified political, healthcare, social, and legal stands. The MOCI presented the recommendations of its Development Project to the GCC, and a draft act for CPA licensing was adopted as nonbinding guidelines in 1987. A committee was later commissioned in 1998 to undergo a similar development project, and a new organization to oversee the accounting profession in the GCC member countries was approved in 1998.

The GCC Accounting and Auditing Organization (GCCAAO) was established in 2001, and a set of accounting standards was prepared under great influence of what had been developed in Saudi Arabia. The objective was to have common accounting practices to be followed across all the GCC countries, as part of the preparation required for the potential economic unity in the future. Such efforts, however, remain as an initiative since there have been no formal requirements to impose compliance with those standards on one hand and the general direction by some member countries to pursue the IFRS, where they felt less urged to develop separate accounting standards for the GCC.

GOING FORWARD: THE GLOBALIZATION OF ACCOUNTING STANDARDS

There has been a long debate in the Kingdom whether the accounting profession should move in the direction of adopting IASs and abandoning local standards. The case for globalization in the Kingdom has neither been motivated by the need for international capital and the pressures to attract multinational corporations as in the case of some developing countries nor driven by legal compliance as in the case of European Union countries. The case for globalization in Saudi Arabia is largely driven by internal pressure from some banks, professionals, and regulators. The preference for international standards by the leading international accounting firms, who

audit the majority of public and large companies, is rather obvious as they would be able to have better access to their global resources. Banks and insurance companies have been required by the central bank to follow the IFRS, which is a move that they have supported, but there is still lack of clarity on whether they will eventually have to issue two sets of financial statements under both SOCPA standards and the IFRS. Saudi standard setters, however, were under less time pressure to decide and move in either direction. The debate was far from over until the financial crisis in 2008, when the political pressure became part of the decision equation.

Saudi Arabia became part of the newly expanded G20 forum of leading global economies, which aimed to boost economic recovery and restore confidence in capital markets and the financial system after the credit crisis of 2008. There was a common concern over the transparency of corporate financial reporting, which was partly blamed for having led to the crisis. During their 2009 summit, leaders of the G20 called for more regulations "to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards" (G20, 2009). Clearly, the single set of global standards was immediately associated by regulators and professionals with the available IFRS.

SOCPA reacted to the G20 resolution by setting the debated issue of globalization as a priority. It was feared that if the profession failed to respond quickly, politicians might be inclined to make such commitment in the midst of these global directions with rapid developments. SOCPA formed a steering committee in 2010 with the mandate to assess whether Saudi Arabia should converge into the IFRS, and, if proven feasible, to lay out a roadmap toward achieving this objective. This committee includes representatives of its Accounting Standards Committee, its Audit Standards Committee, the Ministry of Finance, who represent the country in the G20, the CMA, and the central bank. It was important that all concerned regulators are also properly represented in this important and strategic committee and that all different views are realigned within this committee.

SOCPA's Accounting Standards Committee debated the globalization of accounting standards in the light of the recent developments, and it was eventually decided to proceed with the convergence approach of the IFRS and make this recommendation to the committee. This decision was ultimately reached in the light of previous and new pressures by some of the stakeholders, and in line with the general trend followed by most G20 countries, including the United States, where the direction toward convergence is indicated, although a formal decision had to be made by the end of 2011. While the roadmap is still not being finalized, the plan is to

follow a convergence approach of the IFRS rather than an endorsement approach. As indicated in SOCPA's reply to the IFAC (2011), it is expected that the process will be made over multiple phases to be completed within a five-year horizon to ensure a smooth transition and compliance with local regulations. SOCPA would incorporate the IFRS into the Saudi GAAP during the transitional period, which would require revisiting the underlying conceptual framework and existing standards to be in line with the IFRS, and gradually eliminate differences between the Saudi GAAP and the IFRS through revisions to be made to existing standards. It is expected that SOCPA would still retain its authority over Saudi GAAP as provided by the CPA Act.

CONCLUDING REMARKS

The history of accounting and financial reporting in Saudi Arabia is relatively short but with rapid developments. There has been very limited literature on this history, but the early decades of the 20th century up to the 1970s could be marked with very informal financial reporting, influenced significantly by various practices of multinational companies, the international accounting firms auditing them, and expatriate accountants from different countries with diverse accounting backgrounds. Government regulations focused on formalizing the process of financial reporting for mainstream businesses with very limited guidance on its format or content. The external use of financial statements was largely limited to banks and governments funds. During the 1980s, accounting and financial reporting went under a major reform led by accounting professionals to establish the foundation for more formal accounting thought and practices. This effort was self-motivated and driven by economic need and not in reaction to scandals or market crises. The conceptual framework was developed, under a great influence of U.S. thinking, with the aim of unifying accounting practices and building the basis for a Saudi set of generally accepted accounting principles. This goal was further supported in the 1990s with the creation of the SOCPA, which has been delegated the process of regulating accounting practices and the accounting profession. This professional body has modernized accounting and financial reporting in an accelerated manner leveraging on the successes achieved in other developed countries. The process of formulating accounting thought and practices followed a pragmatic approach and focused mostly on adopting already established principles after applying the required localizations, rather than insisting on

developing innovative and new treatments, or resolving controversial topics, which have been referred initially to the U.S. GAAP and recently to the IFRS.

The first decade of the 21st century witnessed a major shift in the use of financial reporting as a result of the growth in capital markets during the 2000s, from merely meeting statutory and bank requirements to increased use and reliance by investors on financial information. The crash of the stock market in early 2006 has changed investor sentiment toward capital markets and led to enhanced financial reporting and more investment decisions being made based on fundamentals, rather than on mere speculative trading. One of the challenges facing the accounting profession is the coexistence of multiple regulators for financial reporting. This has resulted in some struggle, for instance, when banks and insurance companies, who are regulated by the central bank, were required to prepare their financial statements under the IFRS and not under local standards. This direction was part of a long debate among professionals on the issue of globalization of accounting standards, a move which was also supported by large banks and big international accounting firms. While this debate has persisted for years, it has only recently come under strong pressure following the 2008 financial crisis. The fact that Saudi Arabia is part of the G20 has put further political pressure on accounting standard setters to pursue the globalization of accounting standards, in line with overall direction of other key members, including the United States. While it has been announced that Saudi Arabia intends to converge its local standards with the IFRS and consider potentially adopting the IFRS after a transitional period, only history should tell whether this will eventually be achieved.

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CHAPTER 6

SOUTH AFRICA

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INTRODUCTION

The South African accounting profession's auditing and reporting standards were internationally recognized in 2010 (Schwab, 2010, p. 383). The recognition is described as "comforting for South African businesses and financial institutions, including overseas investors" (*Business Day*, 10/09/2010). By 2011, 22% of South African chartered accountants (CAs) worked and resided abroad (South African Institute of Accountants (SAICA), 2011). This international recognition has a long historical development, since the formative years of the accounting profession in South Africa witnessed the contestation of control over practicing rights and training of accountants. When the Dutch traders passed the Cape of Good Hope, their commercial activities introduced accounting practices from the leading trading nation, the Netherlands, to the Cape and subsequently integrated merchant activities at the Cape into the European commercial metropolis. The Italian system of double-entry bookkeeping had become the standard for accounting practice by the 16th century and was accepted by all commercially significant countries, among which was the Netherlands. These accounting principles were transferred to England, thus extending the integration of the Cape in the international trading community following the extended British occupation of the Cape in 1806. Accountancy in South Africa developed an extension of accounting practice from Italy, through

the Dutch merchants of the Dutch East India Company (DEIC), and, finally, through the English imperial context.

This chapter will address the evolution of accountancy in South Africa since the Dutch company rule, the British imperial control, and, finally, as the professional activity of a South African profession. The chapter will address the development of accounting techniques, the development of professionalization and closure, and the manifestation of excellence in accounting practice that earned the profession the acclaim afforded to it by the World Economic Forum.

EARLY ACCOUNTANCY UNDER DUTCH INFLUENCE

Prior to the arrival of the Dutch, no traces have been found of any accounting or bookkeeping practices. The indigenous inhabitants measured wealth in terms of the number of head of livestock owned, and the steward in charge of the cattle or other form of wealth accounted verbally on the material possessions under his authority (Puttick & Van Esch, 1992, p. 2). Formal written records emerged when the *Vereenigde Oost Indische Compagnie* (DEIC) established a refreshment station at the Cape of Good Hope in 1652. Dutch accounting techniques, acquired from the Italian "Method of Venice" (Brown, 2004, pp. 129–130; McMickle & Vangermeersch, 1987, p. 2), were introduced by the DEIC bookkeepers and later perpetuated in the accounting techniques of the British administrations. The Dutch accounts reflected profits and losses, as well as lists of assets and liabilities in journals and ledgers. By the time of the DEIC occupation of the Cape, the Dutch accountants were the leading teaching scholars and merchants using these methods. Dutch accountants and bookkeepers were considered among the best in the world, but the DEIC did not apply all these principles uniformly in all its different international locations. Decentralized bookkeeping included consolidation of the activities of the DEIC's various settlements by a committee of the *Heeren XVII*. At the Cape, DEIC bookkeepers submitted books and financial documents for inspection to the committee. Documents included lists of goods sold, the stocks on hand, outstanding debits and credits, cash in hand, and the credit balance in the bank of exchange. The *boekhouder-generaal* (accountant-general) made up the *generaal joernaal* (general journal) and the *generaal grootboek* (general ledger) based on the trading books of the establishments

(Gravenhage, 1992, p. 27). A “consolidated” balance sheet was drawn up by the committee based on these provided documents. No fixed assets (such as buildings, ships, warehouses, equipage, etc.) were included in the balance sheet, nor was owners’ equity (McMickle & Vangermeersch, 1987, p. 3). The committee was required to “account for its finances” to representatives of the States General and the principal shareholders only once every four years (since it took that long to obtain all the information from all the DEIC settlements) (Gravenhage, 1992, p. 21). The extensive shareholding of the Dutch people in the DEIC was not met with optimal transparency. Several attempts by the majority of the shareholders to inspect the financial affairs or records on a regular basis to gain an understanding of the sufficiency of their dividends was seen as “impertinence” (Kepple-Jones, 1966, pp. 18–19).

The DEIC introduced formal accounting of financial transactions, although the first transaction with the indigenous population was the barter of goods for land, since currency had no meaning to the sellers of the land. The DEIC bookkeeper was a soldier and not trained as a bookkeeper, thus a case of “accounting by non-accountants.” The land acquisition transaction was recorded as follows:

Dr	General expenses	fl 3000	
Dr	Land	fl 1000	
	Cr	Goods account	fl 4000

The “general expenses” and “goods account” were items included in the calculation of profit and loss. It is thus assumed that the DEIC at the Cape at the time were not implementing Jan Ympyn Christoffel’s modern treatment of stock (Brown, 2004, pp. 127–128). The accounting of this transaction applied the concept of double-entry bookkeeping by creating an asset (debit) to the value of fl 1000 and profits (credit) to the value of fl 1000. In reference to this transaction, it was commented:

It is true that this transaction could have been posted more simply without reference to profit, but Van Riebeeck was so devoted to the interests of the company that he was eager to have so considerable a profit recorded in his books, and, according to the system of double entry bookkeeping, he could not make the entries in a less complex manner. (Noyce, 1954, p. 1)

General financial management was conducted by the *Politieke Raad* – paying wages, issuing invoices, as well as legal functions. Extensive administration resulted from the trade with incoming and departing vessels, but a lack of accuracy characterized the keeping of invoices, loading bills, and general stock of goods in the stores. Boëseken commented that “the

books at the Cape in the 1670s, according to the Commissioner, were in a terrible state of affairs – confusing and not set out in a sensible or understandable manner, and also incomplete” (Schoeman, 2001, p. 190). The lack of professional accuracy haunted the DEIC, since a multitude of smaller concerns had developed (among which sailmakers, ropewalks, forges, abattoirs, apothecaries), of which inaccurate control and financial recording would impact negatively on the affairs of the company (Gravenhage, 1992, p. 22). After the termination of DEIC rule in 1795, the British controlled the Cape for a short period until 1803, followed by a brief spell of Dutch government rule (Batavian rule, 1803–1806), after which the British finally conquered and colonized the Cape in 1806. The Batavian Government in the Netherlands instructed her Commissioner J. A. de Mist to report to the Governor of the Cape in the following manner:

[T]he books should be kept in two sections, “Receipts” and “Expenditure”, each under a separate heading, and at the end should be summarized and closed or balanced so that it will be possible to see at a glance what the profit or loss for the year amounted to and in future the book year should begin on 1 January and end on 31 December of each year as is the custom in most offices

The Batavian Government appointed an auditor-general and instructed the “Receiver of Public funds” to balance his receipts with his expenditure by means of accounts and vouchers filed in one book, “because simplicity is virtue, especially in financial matters” (Noyce, 1954, p. 3).

THE IMPERIAL BRITISH EXPANSION – LEGAL FRAMEWORK AND PROFESSIONAL PRACTICE

The British colonial rule brought about a complete overhaul of the administration of the colony and integrated the Cape Colony into the British Empire. British colonial administration included extensive record-keeping of all official activities. The *Cape Colonial Blue Books* were the compilation of comprehensive official records of the Cape Colonial administration. Full fiscal records and economic data contributed to a better regulated and improved environment to conduct business. The predominantly agricultural economy was rapidly transformed after the discovery of diamonds in the northern region of the colony. By 1850, the Cape economy was the most advanced colony in what would, after 1910, become “South Africa.” The total population in 1850 was 285,279 and rose to more than 2.4 million by 1909 (CGH Blue Books, 1855–1909).

By 1865, 67.19% of the employed Cape population was engaged in agriculture and this declined to 64.19% in 1909. The indefinite (including children) and unemployed population changed from 90.32% in 1850 to 34.70% in 1904, meaning that 65% of the population was employed in 1904. Agricultural production was primarily the cultivation of fruit and the production of wheat, stock, and sheep farming, as well as a small-scale maize and sugar production. The wine industry was stimulated by imperial preference under British colonial rule, but this was removed in two stages between 1825 and 1831, which resulted in a drastic decline in wine exports (Du Toit Viljoen, 1951, pp. 195–196; Feinstein, 2006, p. 28; Houghton, 1971, p. 46). Wool exports soon replaced wine as the major export commodity from the Cape Colony (Kirk, 1980, pp. 22–29; Schumann, 1938, p. 36). Agriculture dominated economic activity in the Cape until the discovery of diamonds in 1867 and gold in 1886, after which mining activities served to stimulate commercial and financial enterprise. The business cycles of the Cape economy subsequently reflected the boom and bust of wool farming and financial speculation brought about by the mineral revolution.

Elementary bookkeeping was done by the farmers, but very few records have been preserved. The most notable were the financial statements of 1837 belonging to a farmer, M. F. Van Breda. His successes as sheep farmer were recorded by his bookkeeper, F. G. Watermeyer. These financial statements constitute the earliest known private financial statements in South Africa and were analyzed in 1995 (Van Breda, 1995). The 1837 balance sheet showed all assets on the right-hand side and the liabilities on the left. The bookkeeper indicated in Dutch “*Extract uit het joernaal.*” Considering the valuation of the balance sheet items, the term “present value” is noted, but this might not depict what it means today, as no fair value adjustments are evident. However, it might be included in the “operating expenses” line item in the income statement, but this is unlikely. Based on the values attributed to the flock of sheep, Van Breda concludes that the term “present value” used in the balance sheet corresponds to the “current cost” valuation method, which is described in a more recent International Accounting Standards Board (IASB) *Framework* (IASB, *Framework*, 2001, para. 100). This is consistent with William Jackson’s treatment in his *Book-keeping in the True Italian Form* (1811).

Apprentices hired on the farm were included in the balance sheet, at a value of the cost incurred, and their values were depreciated. This is in line with current amortization of intangible assets (IASB, IAS 38, 2004, para. 74), which indicates a true level of accounting sophistication at the time. The

slaves owned by the farmer were included in the balance sheet as assets, and once slaves were emancipated in 1834 by the British laws (Giliomee, 2004, p. 115), these slaves were written off to the income statement. Van Breda did not write off a large amount, indicating that he had a diversified farming enterprise. The layout and format of the balance sheet and income statement reflect organization from "most important" to "least important" line items, rather than in order of liquidity as is the present form.

The income statement appears to have been derived from the balance sheet. This corresponds to the current IASB assets and liabilities viewpoint, whereby assets have "conceptual primacy" over income and expenses (Bullen & Crook, 2005, p. 7). Prior period errors that had been corrected were adjusted in the current year's income statement, and thus not in line with IAS 8 (IASB, IAS 8, 2005, para. 42), where errors need to be corrected "retrospectively," with an adjustment to the opening balance of the latest reported period's retained earnings.

These reports and financial documents were prepared with great sophistication, which raises the question about the origin of Watermeyer's knowledge to perform such sophisticated bookkeeping. Was the source of his skills Dutch or British? Both Michiel Van Breda and Watermeyer were of Dutch descent, and all of their notes, summaries, and explanations were in Dutch; however, the financial statements are in English. It is possible that the bookkeeper was in possession of *Jones's English System of Book-keeping* by Edwin Thomas Jones, published in 1796. Earlier copies of this book have been found in archives across South Africa, and it was considered a most significant English accounting textbook at the time.

A cyclical downswing caused by the wool boom of the 1860s, followed by a drought, was reversed by the discovery of diamonds in the late 1860s. General commercial and financial recovery lured businessmen and miners from across the globe to the mines. The imperial banks opened for business in the Cape Colony, which transformed the financial sector of the British colonies and the Boer Republics. These developments were intensified when gold was discovered in the late 1880s. The economy of the entire region was transformed from primarily agricultural to mining and a fast-growing manufacturing sector. These developments created an environment conducive to business enterprise and investment. Noyce observed: "Large financial deals, amalgamations, flotations and the limited liability company, coupled with the need for protection of the public, required the services of the accountant and auditor" (Noyce, 1954, p. 2). Skilled people who could facilitate the growth of the blossoming economy flocked to the ZAR, among them accountants of the "modern era" (Kepple-Jones, 1966, p. 112).

Developments in statutory regulation of companies in the British colonies in southern Africa followed the British model (Cilliers, Benade, & De Villiers, 1973, pp. 12–14; Pyemont, 1906, pp. 2–3). Britain needed to fund warfare in Europe and that led to the introduction of income tax. The keeping of exact records of transactions on national, municipal, and personal level was imperative and was responsible for the ascending importance of those skills associated with the technicalities of bookkeeping and accounts (Stacey, 1954, pp. 7–10). The first Companies' Act passed in "South Africa" was the Natal Joint Stock Companies Limited Liability Law of 1864, followed by the Cape Joint Stock Companies Limited Liability Act, No. 23 of 1861, the Companies Act of 1862, the Winding-Up Act, No. 12 of 1868, the Companies' and Associations Trustee Act of 1873, and the Joint Stock Companies Act, No. 13 of 1888. These statutes provided for the formation of companies and associations with or without limited liability and required the compilation of annual financial statements and the auditing of companies' financial statements, following the example of the British Companies' Acts of 1844, 1856, and 1867. The Cape of Good Hope Companies Act, No. 25 of 1892 (Pyemont, 1906, pp. 423–494) consolidated the earlier legislation to become the benchmark in companies legislation to the South African colonies by the time of the mineral revolution and subsequent immigration to the region.

The accountancy profession in the British colonies was given statutory recognition by the 1892 Cape Companies Act. The Act required companies to keep accounts of the stock of the company, sums of money received and expended, and of the credits and liabilities of the company (Schedule 3(77)). Statements of income and expenditure for a past financial year were to be submitted to the general meeting of shareholders once a year. Those statements must show gross income, sources of income, gross expenditure, and distinguish between expenditure of the enterprise, salaries, and other items "so that a just balance of profit and loss" could be considered (Schedule 3(79)). A balance sheet reflecting a summary of the property and liabilities of the company had to be compiled according to a prescribed schedule. The Act required an annual audit by an auditor of the accounts of a company and he may request the assistance of an accountant to examine such accounts. The auditor's report had to indicate whether the balance sheet is "full and fair," compiled according to regulations and "exhibit a true and correct view of the state of the company's affairs" (Schedule 3(93)) (Pyemont, 1906, p. 489). These specific requirements of accounting and auditing were necessitated by the growth and modernization of business in the Cape Colony, and with business enterprises in Britain and the other

British territories in the region. Subsequent amendments to the Companies' Act in the Cape in 1906 and 1908 perpetuated the auditing requirements of the 1892 Act.

The Natal Joint Stock Limited Liabilities Law, No. 10 of 1864, made no reference to duties for accountants or auditors, but the Winding-Up Law, No. 19 of 1866, provided for the appointment of an "official manager" to wind up a company, granting him the prerogative to appoint bookkeepers and clerks to assist him in the duties (Pyemont, 1906, pp. 589–608).

In the ZAR, the first legislation pertaining to companies was the Limited Liabilities Companies' Act No. 5 of 1874. No reference was made to any responsibility of accountants or auditors, but companies had to register with a Registrar of Deeds, to whom annual reports were to be submitted in June/July. In an amendment of Law 5, Law 1 of 1891 acknowledged an accountant as "an expert" capable of verifying the correctness of statements pertaining to prospectus notice for the purpose of issuing shares in a registered company (Law 1 of 1891, Sec. 1A(b)) (Pyemont, 1906, p. 546). An office of "Registrar of Companies and Patents" was also established in the office of the Registrar of Deeds (Law 1 of 1891, Sec. 6) (Pyemont, 1906, p. 548). The ZAR passed Law No. 1 of 1894 to provide for the liquidation of companies, without reference to accountants, but liquidators were commissioned to perform the liquidation, which would be supervised by the Master of the High Court. The liquidator had to "file a proper account and plan of distribution at the Masters' Office," implying some knowledge of accountancy on the part of the liquidator (Pyemont, 1906, pp. 551–553). Under British colonial rule since 1902, the Transvaal Proclamation No. 12 of 1902 provided for the registration and charge of duty on capital of limited liability companies. Societies and Associations Incorporation Ordinance, No. 56 of 1903 provided for the incorporation of societies. The Limited Liability Company Law (Law 5 of 1874) was amended by the Limited Liabilities Companies' Amendment Ordinance of 1904, without mention of required auditing by accountants and auditors. In the Republic of the Orange Free State, Chapter C of the law book provided for the registration of limited liability companies, but auditors were only mentioned insofar as a company's auditor could not be related as family to a director of the company or be in his/her service (Pyemont, 1906, p. 572). The British Companies Amendment Ordinance of 1904 in the Orange River Colony likewise made no reference to specific duties for accountants or auditors in setting up, registering, or liquidating companies (Pyemont, 1906, pp. 584–588). The professional roles of accountants and legal practitioners were not distinguished or fully demarcated.

By the beginning of the 20th century, the Transvaal Companies Act, No. 31 of 1909 was based on the British Companies (Consolidation) Act of 1908. The Transvaal Act required the convening of an annual general meeting (AGM) of shareholders (Sec. 61(1)) to whom an audited balance sheet had to be submitted (Sec. 61(2)). The AGM of shareholders was required to appoint a public accountant as auditor and stipulated the rights and duties of such an auditor in Sec. 99 of the Act. In case of liquidation of a company, an auditor was also required to inspect the accounts prepared by the liquidator (Sec. 131). This Transvaal Act followed the British Company Law and laid the foundation for new legislation. In 1926, the Companies Act, No. 46 of 1926, was the first South African companies act. All former colonial statutes remained in force until 1926, when Act 46 of 1926 repealed the entire collection of company statutes of the period before 1926. Act 46 of 1926 was amended several times until replaced in 1973 with the new Companies Act, No. 61 of 1973 (Cilliers et al., 1973, pp. 16–17). The companies legislation since 1909 cemented the professional role of accountants and auditors in business in South Africa.

ACCOUNTANTS AND PROFESSIONAL ORGANIZATION

Statutory recognition of the professional function of accountants and auditors secured for the profession an uncontested role in the world of business. Who would be allowed to practice as accountants and auditors was intensely contested all over the world, including in Britain and, subsequently, also in the British colonies that formed the constitutional Union of South Africa. The economic “revolution” following the discovery of diamonds and gold in what was later to become South Africa led to the influx of capital and businessmen (Davis & Huttenback, 1988, pp. 35–39). As mining, banking, commercial, and transport business expanded and failed, the demand increased for skilled accountants capable of recording complex transactions and facilitating the winding up of unsuccessful enterprises. The railway development in the United States created the demand for more intricate methods of financial control (Pollins, 1984, p. 332) and so did the mining revolution in South Africa. British-trained accountants exported their skilled labor rapidly throughout the British Empire from the second half of the 19th century. Many British accountants emigrated to South Africa (Parker, 2001, pp. 598–599). They brought with

them accounting expertise, their mode of labor organization, "symbolic" capital, and occupational norms (Chua & Poullaos, 2002, p. 411). These accountants soon replicated their British organizations in the colonies. In the ZAR, accountants from various accounting associations in the United Kingdom settled and established organizational structures to protect their professional interests. Professional self-regulation through professional organization was a clear sign of professionalization. Wilmot noted:

Professional associations have sought to create monopolies of labour by restricting entry, by determining the type and duration of training and by regulating the mode of standards of practice. These monopolies are all the more effective for being hidden by a cloak of gentlemanly conduct, specialist expertise and state legitimization. (Wilmot, 1986, p. 563)

One of the important mechanisms of professional closure is control over access to practicing rights. Accountants use professional examinations and practical experience to restrict entry.

Accountants soon organized themselves – first in the ZAR, where the first association of accountants to establish a formal organization was the Institute of Accountants and Auditors in the South African Republic (IAASAR), formed in 1894. Its articles of association and bylaws stated that the need for a professional organization is not for gain "but the Institute aims at the elevation of the profession of Public Accountants as a whole, and the promotion of their efficiency and usefulness by compelling the observance of strict rules of conduct as a condition of membership, and by setting up a high standard of professional and general education and knowledge, and otherwise" (IAASAR, 1894). The explicit statement of a "high standard of profession" as premised on "education and knowledge" emerged as a strategy from the end of the 19th century to secure "power" or market control through "education and knowledge." Several members of the IAASAR were members of the Society of Accountants and Auditors (SAA) in England. These were accountants such as George Richards, F. W. Diamond, and the two Woollan brothers, F. M. and B. M. Woollan (Garrett, 1961, p. 56; TSA Membership List, 1904). Several SAA members had established themselves in public practice in Cape Town, Johannesburg, Pietermaritzburg, and Durban. These accountants established the SAA South African Committee in Cape Town in 1895 (Garrett, 1961, pp. 14 and 56) and an Institute of Accountants in Natal in 1895 (Parker, 2001, p. 598; Van Rensburg, 1990, p. viii). The SAA accountants' involvement with the emerging business activities was noted in the February, 1896 issue of its journal, *The Incorporated Accountants' Journal* (p. 53):

It is not our practice to notice in these columns current political events but the position of affairs in South Africa is of deep interest to the profession generally, on account of the enormous capital embarked in gold and diamond mining and other industries in the respective colonies and states, and of special interest to the Society as the South African members are prominently identified with the leading companies on the Rand and elsewhere.

The IAASAR justified its existence on the grounds that their members served as liquidators acting in the winding up of companies, as receivers under decrees, and as trustees in bankruptcies or arrangements with creditors, as well as "in various other positions of trust under Courts of Justice, as also in the auditing of accounts of public companies, and of partnerships, and otherwise" (IAASAR, *Bye-Laws*, 1894). The execution of such professional functions was explained as a prerequisite for the development of sound business and a strong economy in the ZAR (TVR, 148/98: Draft Bill Incorporated Accountants and Auditors in the South African Republic, 18/07/1898; TVR 127/99, *Concept Wet*, 1899). Attempts by the IAASAR to obtain incorporation from the ZAR Legislature was interrupted by the outbreak of the South African War in 1899. After the war, the members reconstituted the IAASAR in 1902 as a branch of the SIAA in London. (The SAA changed its name to the Society of Incorporated Accountants and Auditors (SIAA) in 1897) (Garrett, 1961, pp. 19 and 57; Woolf, 1986, p. 179). The decision of the IAASAR to reconstitute itself as a branch of the SIAA in London was directly related to the maintenance of standards and execution of examinations. The bylaws of the Society's Transvaal branch made articles of clerkship a precondition to write the intermediate examination and "satisfactory evidence of training and general fitness ... to sit for the final examination." In 1902, the bylaws were revised and the Council was authorized to elect to membership persons who had not yet passed examinations, considering a person's "length of experience and professional standing and character of the applicant" (Garrett, 1961, pp. 20–21; Parker, 2001, pp. 598–600).

The contest between British accounting associations in the United Kingdom impacted on the Transvaal Colony (the name of the former ZAR under British Colonial rule since the Peace Treaty of Vereeniging of 1902 concluding the South African War). The failure of the SIAA and the Institute of Chartered Accountants in England and Wales (ICAEW) to find common ground on a merger strategy after the ICAEW had obtained a Royal Charter in 1880 (Stacey, 1954, p. 24; Walker, 2004, p. 129) was transferred to similar competition in the Transvaal. The English accountants in the Transvaal, who belonged to the ICAEW, organized themselves

into The Institute of Chartered Accountants in South Africa in 1904, thereby establishing a presence in the Transvaal Colony alongside the SIAA. Renewed efforts to secure legislative incorporation in the Transvaal in 1902 by the SIAA branch in the Transvaal met with opposition from the Institute in the Transvaal to potential monopolization of the domain. Intervention by the Transvaal Colonial Government led to the promulgation of the Accountants' Ordinance, No. 3 (Private) of 1904 in the Transvaal as a joint effort. The Ordinance legislated the formation of The Transvaal Society of Accountants (TSA) and compulsory registration of accountants as precondition to public practicing rights (Staatsekretaris Sukke (SS), SS/4735: Minutes of IAASAR Meeting 26/05/1902; SS/4744: Deed of Agreement, 1902; Brown, 1905, pp. 265–267; TSA, First Annual Report, 1906, p. 1). Only accountants resident in the Transvaal could register and practice in the colony (Sec. 7), but provision was made for the rights of accountants from recognized accountancy bodies in England, Wales, Ireland, and Scotland to register with the TSA in 1904 (Sec. 6).¹ Registration under the designation "Registered Accountant of the Transvaal" was the only means of acquiring practicing rights in the Transvaal. Although all the TSA members were qualified accountants of British origin, they moved swiftly to restrict access to the growing market for professional accounting services.

Soon, similar accounting associations emerged in neighboring British colonies. In 1907, the Society of Accountants was formed in the Cape Colony (SACC – name changed to Cape Society of Accountants in 1921, CSA; SACC Minutes, 12/02/1907) under the Companies' Act of 1892 (SAA&A, 1907, p. 71). In 1907, the accountants in the Orange River Colony also formed a voluntary association, the Society of Accountants and Auditors in the Orange River Colony (SAAORC) (SAAORC, *Minutes of meeting of practising accountants*, 21/01/1908). Despite the fact that the majority of the accountants convened for the formation of the society were members of the SIAA in England, the decision to accept the designation "Registered Accountant of the ORC," rather than the more English "Incorporated Accountant," created the impression that the English-speaking accountants in Bloemfontein, capital of the ORC, were desirous to demonstrate their "independence" from the English societies from the outset (SAAORC, Minutes, 30/01/08).

The Natal accountants followed the TSA example by securing the passing of the Natal Accountants Act, No. 35 of 1909, which resembled the Transvaal Ordinance of 1904 by making registration a precondition to public practicing rights (TSA, Annual Report, 1907, p. 2). In 1909, when the Natal Accountants' Act was passed, the Natal Society of Accountants

(NSA) was established as the only professional association of accountants in the colony with whom accountants could register to be eligible to practice as an accountant (NSA, *Year book*, 1912, pp. 5–15). The NSA recognized the same British professional organizations as the TSA and granted members of TSA the right to practice in Natal (NSA, *Year book*, 1912, Bye-Laws, Art. 43). The Transvaal and Natal societies were incorporated by means of a statute of the legislature of the Colony, thus making public practice as an accountant dependent on membership of the statutory sanctioned society of accountants. The TSA and NSA monopolized the practicing rights, but their members held dual membership also of the branches of the SIAA. The South African Committee of the SIAA maintained its branches in South Africa until 1957, when the SIAA merged with the ICAEW. In the statutory sanctioned accounting environment of the Transvaal and Natal, practicing rights depended on society membership, but in the Free State and the Cape, voluntary membership was not a prerequisite for public practicing rights.

The TSA had the largest membership of the societies – 593 upon formation (TSA, Annual Report, 1906, p. 4). It was the leading accounting society in the country and took the initiative of ensuring a high standard of public practice. The first president of the TSA, Howard Pim, responded to scathing criticism of the ICAEW against the restriction of practicing rights in the Transvaal, by stating that

[T]he Transvaal Society of Accountants is working with but one end in view, and that is the consolidation and advancement of our profession in this country. We may not be following lines which are possible, or even desirable, in the Old Country, although I, personally, do not admit that this is the case. One thing, however, is certain, and that is that in this, as in so many other departments of public affairs, we must know our own business best, and we have every right to manage it ourselves. (TSA, Annual Report, 1906, p. 11)

The Accountancy Ordinance of 1904 was explicitly inclusive – accountants from seven recognized accounting associations in Britain were eligible for registration as TSA members. The entire knowledge base of those societies was combined in the collective intellectual capital that informed the examination activities of the TSA. All the other local societies followed the TSA example on inclusivity. The different South African accounting societies were displaying a more advanced integrated professional organization than the associations in the “Home.” It was from this intellectual knowledge base that the societies sought to promote the profession in South Africa.

The first strategy to manage the affairs of the accountancy profession was to regulate access to the profession by setting examinations for future

qualifying candidates. Section 16 of the Accountants' Ordinance, No. 3 of 1904, authorized the TSA to formulate the rules and regulations for examinations and prescribe practical experience as conditions for membership, set out in Sec. 7 (Accountants' Ordinance, Sec. 7, p. 16). The TSA bylaws were adopted in February 1905. The requirements for the intermediate examination were set out in bylaws 69–71 and the requirements for the final examination in bylaws 72–74. The intermediate examination covered the following subjects: bookkeeping and accountancy (including partnership and executorship accounts); rights and duties of liquidators, trustees, and receivers, as well as elementary political economy (TSA, *Year book*, 1905, pp. 34–35). The final examinations covered the following subjects: bookkeeping and accounts (including partnership and executorship accounts and the law pertaining thereto); auditing; rights and duties of liquidators, trustees, and receivers; the principles of the law of bankruptcy; principles of mercantile law; and principles of the law of arbitration and awards (TSA, *Year book*, 1905, p. 36).

The first examinations in South Africa were conducted in Natal in 1895 under the auspices of members of the SIAA in Natal (Brown, 2004, p. 264; Noyce, 1954, p. 6). The TSA set up an Examinations Committee in April 1905. The examinations were held in Cape Town and Johannesburg on questions set by the U.K. examiners, except for the legal papers, which were prepared on South African law by local experts (Garrett, 1961, p. 57). The first examinations were written in the Transvaal in December 1905 – with not unexpected “not exceptionally high” percentages obtained (TSA, Annual Report, 1906, p. 12). Pim stated that, “the Council were, I think, justified in applying a somewhat higher standard ... [in the final examination of Accounts] ... We are Accountants, gentlemen, first and foremost. By our proficiency in accounts we shall be judged ...” (TSA, Annual Report, 1906, p. 12).

Pim indirectly expressed two important principles that would have a profound impact on the future of the accounting profession in South Africa. The first was that the profession in South Africa, despite its English heritage, would control its own professional status, or exercise professional self-regulation. The second was that service to the growing business community and economic development of the country depended on professional standards of the highest quality, a matter the profession considered its responsibility. At the 1907 Annual General Meeting of the TSA, Pim expressed his concern over the delay in the Natal Parliament with the promulgation of the Accountants' Bill. The reason for the anxiety was that

Your Council understand that a similar effort is being promoted in the Cape Colony for the registration of Accountants and would heartily welcome the completion of these steps towards providing for compulsory Registration of Accountants throughout South Africa, so that there may be in the near future reciprocity among all the states of South Africa in this respect, with one Examining Board. (TSA, Annual Report, 1907, p. 2)

In the *South African Accountant and Auditor* (April 1907) notice of the formation of the SAC was announced as

[A] Society ... which is incorporated as an educational institute in pursuance of the following objectives: a) obtain legislative recognition for the profession; b) to unite the accountants of the Cape Colony by means of a Colonial Society; c) by systems of examination, similar to those adopted by the Home Societies, to admit as members those who are qualified to practise their profession.

The Natal Society's examination function was transferred to the NSA after 1909 (NSA, Bye-Laws, Secs. 58–62). The formation of the four societies signaled the first achievement toward professional closure in South Africa. The consolidation of this position depended on control of future admissions, which depended on the professions' control of its knowledge base, i.e., its examinations and practical qualifying conditions.

UNIFICATION AFTER UNION?

The four societies of accountants were eager to capitalize on the formation of the Union in 1910 and to join their interests by means of a single statute. A conference of the four professional accountants' societies in 1911 discussed, among other things, the unification of the profession (Noyce, 1954, p. 7; Van Rensburg, 1990, p. 22). Consensus on a Draft Union Accountant's Registration Bill (1912) was achieved. The draft bill was considered by a Select Committee of Parliament, but objections were raised to the preamble to the bill, as well as to the principles of "Compulsory Registration" (SAAOFS, *Minutes of Council*, 23/09/12; SAAOFS, *Minutes of general meeting*, 23/09/12; TSA, *Minutes*, 7/3/13). The proposed private bill failed to reach the final stages of promulgation as a result of objections from other associations of accountants. The Societies took the initiative of seeking statutory recognition of the status of the profession and did not seek state intervention in regulating their professional affairs. The profession subscribed to the principle that it was the profession's prerogative to examine, give credibility, and license its members, using its own professional structures to ensure professionalism in training and conduct, and only sought a statutory sanction of its status.

World War I further disrupted endeavors to pass legislation to formalize the unification of the profession of accountants in South Africa (Van Rensburg, 1990, p. 28). Failing in their first unification attempt, the four Societies and the Rhodesian Society of Accountants met in August 1919 at a Special General Meeting of the provincial societies to bring about "as far as possible a common standard of qualification if not by Ordinance then by agreement amongst the Societies themselves" (TSA, Minutes, 12/08/19, 02/02/19, 4/11/19, 26/02/20, 2/11/20). The Societies decided to establish The South African Accounting Societies' General Examining Board (GEB). The TSA and NSA started in 1919 with a joint examination for their articulated clerks and other candidates. The Rhodesian Society of Accountants agreed to provide uniform conditions of admission, examinations, and regulations for service under articles of clerkship. The meeting recognized qualifications acquired outside the Union. Delegates of the Society of Incorporated Accountants (South African branch) attended the meeting. It was agreed that candidates wishing to qualify as "Incorporated Accountants" in the United Kingdom could complete articles under the rules of the SIAA's South African branches, complete the GEB examinations, save for the legal papers that would be set in London, "modified to South African practice," adjudicated by London examiners and results finally determined by the London Council of the SIAA. (This was the so-called Reciprocity Agreement (Garrett, 1961, pp. 145, 203–204, and 297; GEB, Minutes, 26/06/26)). Upon return to South Africa, those qualified as Incorporated Accountants were eligible for membership of any of the South African Societies (Howitt, 1966, p. 175; IAJ, vol. 32, p. 210; SAAOFS, Minutes, 25/11/25). This reciprocity agreement was one-sided reciprocity: accountants who qualified under the local Societies' examinations and later GEB examinations were not offered the return privilege of eligibility to become an "Incorporated Accountant" of the U.K. SIAA. The relationship could be explained by the excellent cooperative relationship between the SIAA members in South Africa and the local Chartered Societies – many of whom held dual membership. In 1920, the SIAA had more than 160 members in South Africa (SIAA, *Year book*, 1920, p. 431).

During the GEB negotiations, the concession to the ICAEW to conduct examinations in South Africa or register articulated clerks in the Union was withdrawn. The Institute acknowledged the standing of the Societies in the Union, as well as the high standard of GEB examinations. Articled clerks of the Institute were only required to complete a Special Final Examination of the Institute to qualify for ICAEW membership in the United Kingdom (TSA, Minutes, 6/07/20). This agreement recognized the professional

standing of the Societies and the training of articled clerks, as well as conduct of examinations in South Africa. The final draft of the Memorandum of Agreement was ratified by the respective South African and Rhodesian Societies by December 20, 1920 (TSA, Minutes, 11/01/21).

The success in establishing the GEB gave the Societies' confidence to resume their efforts for uniform statutory registration of the public accountants under their auspices. The GEB agreement further marginalized other organizations of accountants in South Africa that were not acknowledged in the Accountants' Ordinance of 1904, the Natal Accountants' Act of 1909, or the Memorandum of Agreement on the GEB. The GEB came into existence on May 6, 1921, and represented the first step toward a single professional organization of accountants in the Union and Rhodesia (GEB, Minutes, 16/08/21). The GEB promoted cooperation and deliberation among the professional societies on matters of statutory recognition, admission, examination, and practical training through articles of clerkship and standards. The GEB agreement stipulated the qualifications for membership of the four South African Societies (clauses 1–3), the age and conditions of articles of clerkship (clauses 4–6), and the examinations required to qualify as an accountant (clauses 7–23). Articles of clerkship could only be completed under the supervision of an accountant who was a practicing member of one of the Societies. Admission to such articles could be obtained at the age of 17 upon either presenting a Preliminary Certificate or a Matriculation Examination of the Joint Matriculation Board of the University of South Africa, Stellenbosch, and Cape Town (clause 7). After four years, the candidate was permitted to sit for the Intermediary Examination and after another two years for the Final Examination (clauses 8–15). The agreement allowed a one-year exemption of articles to candidates who had passed the second as well as third examinations in the professional subjects at a university (clause 16). The four Societies each nominated members to constitute the GEB, which took full responsibility for the examination of the candidates, from the Intermediate to the Final Examinations (clauses 24–34).

The qualifying framework of the examinations constituted by the GEB syllabus formed part of the agreement. The syllabus consisted of the following:

Intermediate Examination: Schedule of subjects included

(1) General Professional Knowledge

- Bookkeeping and Accounts (including Partnership and Executorship Accounts)
- The Rights and Duties of Executors, Trustees and Liquidators
- Auditing

(2) Elements of Company Law

Final Examinations: Schedule of Subjects included

(1) General Professional Knowledge

- Bookkeeping and Accounting (including Partnerships and Executorship Accounts and the Law relating thereto)
- Auditing
- The Administration of Estates of Insolvents, of Deceased Persons and Estates under Deeds of Assignment, Curatorship and the Administration and Liquidation of Companies

(2) Law

- The Principles of the Law of Insolvency
- The Principles of Company Law
- The Principles of Mercantile Law
- The Principles of the Law of Arbitration and Awards
- The Rights and Duties of Liquidators, Trustees, Executors and Arbitrators

(3) Political Economy

(4) Special Paper on Advanced Auditing and General Practice (TES, 9/350/1/2386 Memorandum of Agreement)

The GEB syllabus showed a remarkable resemblance to the syllabus of the first examination of the TSA in 1905. The leading role of the TSA in facilitating the conferences, as well as the correspondence, objections, and proposals for consideration until final consensus had been achieved, explains the similarity. As noted by the TSA president, John Dougall, "A great deal of spade work had to be done both in regard to this Agreement and also ... with consideration of the claims of various applicants for the Society's Examinations" (TSA, Annual Report, 1920, p. 18; TSA, Minutes, 14/12/20, 11/01/21, 12/04/21).

The power knowledge nexus in the professional societies of accountants was entrenched by this agreement. Membership of the Societies (with reciprocity to foreign associations) was a prerequisite for the contract of articles of clerkship and successful completion thereof for entry into and successful completion of GEB examinations. In the absence of statutory protection of the accounting profession, the professional associations had achieved full monopolization of the regulation of practicing rights and admission qualifications. The syllabus content displayed a predominant focus on the accounts of companies, partnerships, and other commercial entities. Much attention was paid to insolvencies, liquidations, executorships,

and companies' and mercantile law. This was predetermined by the needs of business in a rapidly growing economy. As Wallace (1990) noted, U.K. accounting systems had laid stronger emphasis on external reporting to investors and external auditing, and that was exactly what the profession had entrenched in the early foundations of accounting knowledge in South Africa. Former British accountants, who had settled in colonial settler societies, developed a qualification framework similar to the "Home" system of examinations, articles of clerkship, and qualifications.

The only difference in South Africa was that the professional societies had aligned themselves closely with universities from early on. In 1919, the TSA had already contributed several hundred pounds toward the Transvaal University College in Pretoria and the Johannesburg School of Mines (later to become the University of the Witwatersrand) for the funding of the accounting courses. In 1920, the president of the TSA noted:

It is recognised that courses in accounting conducted by Professor Findlay and Mr Francis Dix at the University College here and by Mr S R Barnes at the Transvaal University College, Pretoria, have been pre-eminently useful in coaching the students for the Society's examinations. Indeed without such tuition a candidate, I feel, stands small hope of acquitting himself satisfactorily at these tests. (TSA, Annual Report, President's Speech, p. 15; GEB, Minutes, 13/01/22; 27/03/22)

The Societies encouraged candidates to sign up for the correspondence courses offered by Prof. Findlay preparing students to sit for GEB examinations. (SAAOFS, Minutes, 20/01/23, 18/12/23, 31/01/24). The close relationship with universities was entrenched in the GEB agreement, but the GEB did not accept the university graduates' B.Com. degrees as sufficient qualification for accountants. The GEB maintained close scrutiny of university courses and standards of examinations, stating that students who entered the B.Com. degree with the view of qualifying for the accountancy profession must comply with Sec. 7 of the Memorandum of Agreement, i.e., pass the matriculation examination of the Joint Matriculation Board. Only under those strict conditions could students apply for exemption from certain subjects of the GEB (GEB, Minutes, 24/10/21, 9/04/22, 9/06/22).

CLOSURE THROUGH DESIGNATION

In 1927, the accountants' profession achieved another professionalization milestone when the Chartered Accountants' Designation (Private) Act of 1927 was promulgated. Only accountants who had acquired their

professional qualifications by succeeding in the examinations prescribed by the GEB and who had completed the required years of articulated clerkship were permitted by this law to designate themselves as "chartered accountants" of South Africa, CA(SA) (TSA, Minutes, 25/10/27; GEB, Minutes, 27/11/27; SAAOFS, Minutes, 3/05/27, 15/06/27). A threat by a Member of Parliament, Charles Pearce, to table an opposing private bill on the grounds that the proposed designation bill would discriminate against long-standing accountants in public practice, who were not members of the local Societies, led to an amendment to the Designation Bill. A deadlock was averted by a compromise with Mr. Pearce. He offered his support for the Designation Bill, on condition that persons of good character, in public practice for more than 10 years or between 5 and 10 years, would be allowed an opportunity to prove their knowledge of accountancy and auditing to the Societies in a moderate examination. (This was the so-called Pearce Agreement) (TSA, Minutes, January–December, 1926, 12/07/27; SAAOFS, Minutes, 24/03/27, 14/04/27). Most of the applicants were from the Cape – only 73 of 245 applicants were successful. The Designation Act was the first statutory recognition of the professional status of the four Societies, since only members of the Societies, who had successfully completed their examinations, were allowed to designate themselves "Chartered Accountants (SA)." The act recognized the original British monarchical sanctioning of the status of accountants, by extending that professional standing through their professional conduct and examinations in South Africa in terms of the legislation in the Transvaal in 1904 and Natal in 1909, and the Designation Act in 1927.

The South African accountants showed a growing sense of professional confidence. The reciprocity agreement with the SIAA soon compromised the Societies' stance on high educational standards. In March 1925, Prof. Galbraith, president of the CSA, lodged a written complaint against the low standards of the SIAA examinations, both in the intermediate as well as the final examinations. He showed a discrepancy for the period 1922, 1923, and 1924 of an average pass rate of 72.8% in the SIAA examinations and an average of 41.9% in the GEB examinations. It was noted that candidates had opted rather to sit for the SIAA examinations, passed them with greater ease than the GEB examinations, and then returned to South Africa to join the South African Chartered Societies (GEB, Minutes, 23/03/25). The SAAOFS had noticed that a very small number of candidates in the province sat for the GEB examinations, compared to those choosing to write the SIAA examinations in the United Kingdom (SAAOFS, Minutes, 23/06/26). In 1926, the NSA lodged similar complaints, calling for the

immediate termination of the agreement with the SIAA to conduct the SIAA examinations in South Africa (GEB, Minutes, 29/03/26, 26/06/26). The GEB subcommittee appointed to investigate the matter reported in the affirmative to the GEB. The GEB request to the SIAA to terminate its own examinations and accept the GEB as the sole examining authority in South Africa was met with outright refusal (GEB, Minutes, 6/09/26, 25/01/26). At a conference in June, 1931, the Chartered Societies decided to terminate SIAA examinations in the Union and Rhodesia in 1932. The termination of the reciprocity agreement with the SIAA included full agreement on the GEB examinations, also the preliminary examinations, and a uniform system of articles of clerkship (GEB, Minutes, 6/02/33; TSA, Minutes, 9/07/31, 8/02/32).

Between 1927 and World War II, two further attempts were made to pass private legislation through the South African Parliament to secure compulsory universal registration of public accountants in South Africa. The TSA was then advised by its members that "in order to place the profession in South Africa on a satisfactory foundation – taking into account the question of unity and control – a reorganisation in the machinery was necessary" (TSA, Minutes, 11/29). Other organizations of accountants in the Union, among them the ICAEW members in South Africa, were dissatisfied with the privilege bestowed upon the Chartered Societies, while, in the Institute's opinion, equally deserving accounting organizations were excluded from practicing in the Transvaal (TES/536/1/F33/263/4 Letter Institute of Incorporated Accountants – Minister of Finance, 5/4/34, 27/06/32, 17/07/34, 27/07/34). A Private Member's Bill, on behalf of the Institute of Accountants of South Africa, was therefore tabled in Parliament in 1934. The aim was to introduce a universal compulsory registration of all accountants in the Union. This bill did not proceed to the second reading (Hansard, 26/1/34–4/6/34; TES/536/1/F33/263/4 Memorandum Minister of Finance, 5/8/37). The matter was referred to the Accountancy Profession Commission to investigate the qualifications and registration of professional accountants in South Africa and whether it would be "advisable to place the profession of accountancy and auditing in the Union on a qualified basis by the incorporation of a representative body having control over the whole profession and keeping a register in which should be inscribed the names of all qualified members of the profession" (GEB, Minutes, 18/05/34; TES/536/1/F33/263/4 Letter W J O'Brien Esq. – Minister of Finance, 30/06/34; Minister of Finance – H. G. Galbraith, 15/08/34; Report of the Commission of Inquiry into the Accountancy Profession, 1934:1). The Report of the Commission in April 1936 was that the establishment of a

Registry of Accountants "has become a practical and urgent necessity ..." (Para. 26), and declared: "Your Commission are satisfied that the Societies referred to in the Chartered Accountants' Designation Act have reached and maintained the professional status of a high order comparable to the best Societies overseas and that any measure failing to recognise this fact or tending in any way to lower that status would be contrary to the interest of the public and the profession" (TES/526/1: Report, 1934, para. 37; GEB, Minutes, 14/05/36). The report advocated that the senior members of the profession should make a concession if a final and comprehensive organization of the profession were to be achieved and admit as practicing accountants certain persons under suitable terms and conditions "provided they are not admitted to chartered rank" (para. 28(2), p. 29). The different accounting stakeholders failed to reach agreement on this matter.

The Accountants Profession Bill was never introduced in Parliament for a second reading because of strong opposition by the Transvaal Society of Accountants (TES/536/1/F33/263/4 Letter Secretary of Finance – Dr. J. E. Holloway, 6/8/37). Another unsuccessful Private Members' Bill on behalf of the Institute of Accountants of South Africa was tabled in 1936. Cognizant of the division among accounting associations, the state refused to intervene: "[T]he Minister replied that Government was not prepared to bind members to support any particular bill, but that any Society or group of societies were at liberty to proceed in the matter by means of a private members bill" (TES/536/1/F33/263/4 Aide Memoire, Secretary of Finance, 7/9/37; TES 9/350/1/2386: Correspondence Treasury-Chartered Societies, 1937). Another attempt was made in 1938, on behalf of the Chartered Societies in the Cape and the Orange Free State, to secure the right of registration of accountants in those provinces. The bill was referred to a Select Committee in August, 1938. The committee heard that the Cape Society of Chartered Accountants had changed its bylaws to prevent accountants from registering as chartered accountants unless a period of five years' articulated clerkship had been completed under the supervision of a member of that society. The students of the Institute of Accountants of South Africa claimed disadvantage, since, despite the fact that they had successfully completed the examinations of the Institute, they were not allowed to practice in the Transvaal or Natal, as the chartered bodies refused them registration in those provinces. In the Cape and the Orange Free State, the Institute's students, who had passed their examinations with the Institute, were not allowed to take the examinations of the Chartered Societies. The anomaly was that the Cape Society had admitted as members, accountants who had completed "service with articles or continued service

without articles,” thus accountants who had never passed an examination in accountancy (SC, 12/38, pp. 4–10; TES/536/1/F33/263/4 Letter G Hartog – Secretary of Finance, 16/07/34).

The Chartered Societies argued that the Institute of Accountants of South Africa maintained a much lower standard in their examinations, which implied a lowering in chartered accountants’ standard if Institute members were allowed to register (SC, 12/38, p. 32). The 1938 Accountancy Bill, No. 26 of 1938, lapsed because the session of Parliament ended. The bill was reintroduced in 1939, with yet another Select Committee appointed to take further evidence (SC, 8/39). World War II disrupted this initiative (Hansard, February, 1940).

FROM SELF-REGULATION TO STATUTORY REGULATION

The discourse about practicing rights was securely entrenched in the power knowledge nexus. The local Chartered Societies were opposed to the registration of nonsociety members, because the latter had consolidated their control over educational standards through the GEB. After World War II, the Minister of Finance, J. H. Hofmeyr, stepped in and announced the intention of Government to introduce legislation: “The Treasury wishes to announce that it has been decided that a Bill should be introduced into Parliament in the near future to provide for the registration, qualification, designation, and control of accountants and auditors and for related matters” (Hansard, (74) 1951, 4100; JC, Minutes, 2/12/46). The Treasury justified its conduct by referring to the government’s “responsibility to be accountable to the public, through accountability to the legislative executive branches of South Africa” (TES, 9/350/1/2386, Letter Minister of Finance – Joint Council, 21/01/50). The Chartered Societies had in the meantime reorganized themselves into the Joint Council of the Chartered Accountants of South Africa (JC) to signify their commitment toward unified professional practice as well as a readiness to collaborate with government to position and protect the accountancy profession in the country (JC, Minutes, 31/3/45, 10/01/46). The TSA was recognized as “the representative of the professional organisation of accountants, an organisation based on prescribed examinations, membership fees and maintaining a register of members...” (TSA Minutes: Letter Raikes – TSA, 17/01/47; JC, Minutes, 2/12/46) and organized a conference of all accounting bodies in South Africa to arrive at a consensus position on proposed legislation. The Chartered Societies

initially stood by the draft bill of 1938, since "by adhering to the provisions of the draft Bill, outside bodies will, in time, die out" (JC, Minutes, 2/46). Intense professional negotiations internally and with the Government resulted in the promulgation on February 12, 1951, of the Public Accountants' and Auditors' Act, No. 51 of 1951 (Hansard, 12/02/51). A statutory regulating body, the Public Accountants' and Auditors' Board (PAAB), was formed, with whom all accountants in public practice had to register. This registration did not entitle them to CA status, which remained reserved for accountants who had complied with the Chartered Societies' bylaws.

The PAA Act introduced non-accountants to a regulatory position of the accountancy profession for the first time in the British Commonwealth. The PAA Board, appointed by the Minister of Finance, constituted a majority nonchartered accountants (leading civil servants, university lecturers, and members of other accountancy associations, such as South African branches of the Society of Incorporated Accountants and Auditors, the South African branches of the Association of Chartered Certified Accountants (ACCA) of South Africa, the Institute of Accountants of South Africa Ltd., and the Association of Practising Accountants of South Africa) and representatives of the Chartered Societies (PAA Act, Sec. 3). The Chartered Societies' monopolistic control of the profession in terms of the Designation Act of 1927 was permanently reversed.

FROM PROFESSIONAL TO STATE CONTROL

Control over educational standards and professional requirements for qualification was also transferred to the PAAB. As a gesture of inclusivity, a single 18-month window was granted to nonchartered society members to apply to the Accountants' Registration Advisory Committee (Sec. 13) for registration on the PAAB register. This opportunity allowed members of associations listed in the PAA Act an opportunity to acquire registration, but in the future, all registrations would be conditional upon the educational requirements set out in Sec. 21 of the Act. The GEB responsibilities were transferred to the PAAB – responsibility for examinations subsequently vested in the statutory body. The PAAB was conferred sole responsibility to arrange examinations for articled clerks (Sec. 21(1)(e)) and to prescribe degrees, diplomas, and other qualifications that would entitle persons to register as accountants and auditors (Sec. 21(1)(d)). Section 25 of the PAA Act authorized the Board to prescribe the examinations to be passed by

persons desiring to qualify for registration. Former examinations of the GEB were recognized, but the GEB was instructed to deliver all documents pertaining to examinations to the PAAB. The PAAB was authorized to arrange examinations to be concluded on its behalf by any "one or more universities or institutions approved by the Minister ..." (Sec. 25(2)(3)). This arrangement was later referred to as the "university training scheme." The final oversight of examinations by a statutory body represented a fundamental break in the Societies' perception of their responsibility to protect the standing and standards of the profession.

The act transferred oversight of the examination responsibility to the PAAB, providing a statutory body the opportunity to maintain the integrity of the profession, enhance its status, and improve "the standards of professional qualifications of accountants and auditors" (Sec. 21(1) (h)). The Chartered Societies' representation on the PAAB was the only comfort to them, even being a minority. (They had a maximum of seven representatives on a Board consisting of 17 members.) Depending on the nature of the relationship with the representatives from universities, chartered accountants might be able to count on the principled support from universities, but not necessarily from the four government officials. The closer allies seemed to be located in the representatives of the branches of foreign accounting organizations in South Africa. The inclusion by the Joint Councils of representatives from the Society of Incorporated Accountants and Auditors (whose students were accommodated by the reciprocity agreement with the GEB in 1921) and of the Association of Certified and Corporate Accountants, and also the Association of Practising Accountants, helped to nurture intraprofession collaboration, which proved to be vital in sustained control of the power-knowledge base and the protection of the standards and status of the profession after 1951.

PROFESSIONAL EDUCATION: PROFESSION, STATE AND UNIVERSITIES

The post-1951 period of professional training of accountants in South Africa presented a complex nexus between the profession, the state, and universities – a phenomenon unknown to any other British accountancy environment. The profession could no longer monopolize the functions of examining, credentialing, and licensing accountants in South Africa. The profession had to devise a strategy to secure the perpetuation of its influence

over the power knowledge nexus. As a first strategy, the Chartered Societies' conciliatory moves prior to the 1951 Act nurtured professional solidarity.

The second strategy was to capitalize on the long-standing relationship of goodwill and cooperation with the universities. In 1927, the Commission of Enquiry appointed by the South African Government reported that the introduction of B.Com. degrees at universities was a grave error (GEB, Minutes, 22/08/27), but the accountancy profession continued to develop this relationship. This collaboration constituted a far-sighted leading development unknown to other British accounting environments² (Anderson-Gough, 2009, pp. 309–311; Wolman, 1976, p. 176). The *Financial Times* noted in 1926 that, "In comparison with Great Britain, the Universities of the newer world [Canada, Australia, New Zealand and South Africa] exhibited a much keener appreciation of the value of accountancy in the educated business life of today" (Zeff, 1997). The correspondence courses offered by Prof. Findlay, and other courses in accountancy offered by S. R. Barnes at the Transvaal University College, established a sense of shared responsibility. The recognition of subjects passed at universities toward (but excluding) the qualifying accountants' examination, and the exemption of time for articled clerks who had completed university degrees, contributed to the development of a synergy between the profession and the universities. Agreements were entered into between, e.g., the TSA and the University of the Witwatersrand in the 1930s, providing for classes in the specialized accountancy subjects at the university in preparation of candidates for the final examination of the GEB (TSA, Minutes, 1931–1932). The TSA prescribed the educational framework. An official from the University of the Witwatersrand stated that he aimed at making the University the center of all higher education in the City [Johannesburg] "and desired that the University of the Witwatersrand Accountancy course should cover the requirements of the Accountancy profession" (TSA, Minutes, 26/09/31).

The PAAB was unable to take up its educational responsibilities in 1951 and requested the GEB to continue its examination activities. The PAAB appointed an examinations committee to investigate the nature and syllabi of the GEB examinations, the existing agreement between the GEB and the universities, the final examinations of other accounting bodies with respect to possible exemption to successful candidates, and the examinations of the universities in South African as well as overseas (PAAB, Minutes, 28/11/51). The examinations committee consisted of five persons, two university professors (Prof. P. W. Hoek from the University of Pretoria and Prof. B. J. S. Wimble from the University of the Witwatersrand), and three members of the Chartered Societies – all representing the TSA. Some tension was

dispersed immediately when one university professor suggested that the GEB examinations in the past laid too heavy emphasis on practical experience and too little on technical and theoretical matters (PAAB, Minutes, 29/11/51). The PAAB decided at its first meeting to accredit the final examination of certain overseas professional societies (such as the SIAA, ICAEW, Institute of Chartered Accountants of Scotland, of Aberdeen, Institute of Chartered Accountants and Actuaries of Glasgow, etc.) 'until further notice,' thereby reversing the Chartered Societies' position on final qualification in South Africa since 1904 (PAAB, Minutes, 29/11/51, 14/02/52). The PAAB did eventually revisit the applications for exemptions and, in September 1952, finally recognized the final examinations of the ICAEW as well as the articles of clerkship completed by that Institute's clerks under supervision of qualified accountants of the ICAEW. Similar recognition was not granted to the Institute of Chartered Accountants of Ireland (PAAB, Minutes, 25/09/52). Their articles of clerkship of the Irish Institute were acceptable, but the scope of the final examination was regarded as "too narrow," and the examination papers as "not sufficiently advanced" to justify the Board to grant exemption from GEB examinations (PAAB, Minutes, 5/2/53).

Qualifying bodies of professional accountants outside the Union were requested to submit official requests for the recognition of their professional organizations, as well as their qualifications, upon which the GEB then conducted a thorough content and quality assessment. When it was found that the standard of examination, the scope of the syllabus and the term of articles of clerkship were similar to the requirements of the PAAB, the final examinations of such professional organization were accredited. The only additional requirement was a special examination set on South African Law, comprising Mercantile Law, Company Law, Rights and Duties of Trustees, Liquidators, and Executors, and a paper on Union Tax Law (PAAB, Minutes, 14/02/52, 25/09/52).

The PAAB performed extensive duties with respect to the registration of articles of clerkship, recognition of practical service performed under various circumstances, and exemption to clerks for practical services performed under the supervision of accountants of a variety of associations recognized in the PAA Act, as well as subsequently acknowledged by the PAAB (e.g., articles of clerkship completed under supervision of an ACCA accountant, which was never acceptable under the GEB (PAAB, Annual Report, 1953, p. 6; PAAB, Minutes, 1951-1954; PAAB, Annual Reports, 1951-1954). Registering contracts of articles of clerkship, crediting practical experience, and granting permission to sit for the final qualifying

examinations constituted a valuable administrative function which relieved the Chartered Societies of maintaining an extensive bureaucracy. In principle, the qualifying examination requirements administered by the GEB remained the core of the education framework. The arrangement with the South African universities in respect of prescribed subjects passed on third-year level for B.Com. degrees was perpetuated in terms of the PAA Act. The GEB conducted the final qualifying examinations on behalf of the PAAB until 1956 (GEB, Minutes, 1951–1956; PAAB, Minutes, 23/11/56).

The PAAB ratified the following syllabus of the GEB for 1953 (PAAB, Minutes, 25/09/52): The Board examinations included a paper in elementary mathematics and another on elementary statistics. There was a paper on Mercantile Law and a paper on Company Law and the Rights and Duties of Trustees and Executors. A separate paper dealt with income tax. The paper in accountancy covered 38 topics (PAAB, Minutes, 25/09/52). There was a full paper on auditing and the general duties of an accountant. The full paper on cost accounting added another 12 topics, as well as a full paper on accounts for trustees, liquidators, and executors (PAAB, Minutes, 25/09/52). The content of the syllabus was the benchmark for the recognition of overseas accounting organizations' qualifications.

The PAAB was inundated with requests from graduates from across the world for exemption similar to that granted to graduates from South African universities (from all Commonwealth countries, India, the United States, Denmark, Germany, etc. (PAAB, Annual Report, 1955, p. 16; 1956, p. 12). Exemption from practical training was granted, but exemption from academic subjects in preparation for the final qualifying examination was reserved in the wake of PAAB preparations to execute the final qualifying examinations themselves. While the PAAB was unable to conduct the final examinations, a proposal was considered to request the universities to examine the final qualifying examination themselves. The chairman of the PAAB, Mr. Macintosh (a member of the TSA), rejected the proposal, arguing that "control over the right to determine whether students had reached a sufficiently high standard of knowledge, both theoretical and practical, should, for the time being, remain vested in the profession itself" (PAAB, Minutes, 18/02/55). In 1957, the PAAB finally took control of its statutory responsibility to conduct the final qualifying examinations from January 1, 1957. Two changes were introduced: only one final qualifying examination was scheduled per annum and the format changed from four 3-hour papers to three 4-hour papers. The separate paper on cost accounting was removed and questions on the subject matter spread over any of the other three papers (GEB, Minutes, 12/11/56; PAAB, Minutes, 23/11/56).

A "GRADUATE" PROFESSION

The results of the first qualifying examination conducted under the auspices of the PAAB were disappointing, with a 24.3% pass rate (PAAB, Annual Report, 1957, p. 12). In 1958, the pass rate improved to 48.3% (PAAB, Annual Report, 1958; p. 14), but the success rate dropped to 36.5% in 1959 (PAAB, Annual Report, 1959, p. 14), with a slight improvement to 40.7% in 1960 (PAAB, Annual Report, 1960, p. 14). This development prompted the JC to investigate the training and education of the profession.³ A highly critical report prompted the PAAB to appoint its own investigation into the education system for accountants and auditors. The report in July 1962, addressed four matters: the entry qualification of graduates, university education, practical training, and a uniform qualifying examination (TSA, Minutes, 22/07/62).

The first recommendation was that all scholars had to have a matriculation certificate with accreditation for any one of the official languages and mathematics on higher grade level, as well as three other subjects acknowledged by the Joint Matriculation Board as suitable for the accountancy profession. The committee recommended a more "academic" university education with compulsory study in languages in order to assist candidates to express themselves efficiently. Economics was proposed as prerequisite for admission to the Certificate in the Theory of Accounting (CTA). This recommendation was not accepted. The third recommendation, which proposed a change in the articles of clerkship, was rejected, but the fourth recommendation that all candidates having successfully completed the CTA had to pass a uniform final qualifying examination was accepted (PAAB, Annual Report, 1962, pp. 24–25).

This report set the accountancy profession on a long path of repositioning its knowledge power base. The accountancy profession in South Africa was experiencing the impact of the early statutory enforced transfer of the responsibility for accountancy education to a statutory body, while the actual location of education was within the universities. The universities had academic autonomy in determining the structure of educational programs (degrees), which had a direct impact on the intellectual engagement with accountancy. The accountancy profession had in actual fact retained indirect control of the examination framework through the dominant presence of CA(SA)s on the PAAB education subcommittee, and collaboration with the university representatives on professional standards and an education framework. By 1960, most of the South African universities participated in the university training scheme for accountants

(PAAB, Annual Report, 1956, p. 4). The syllabi of the PAAB for the qualifying examinations were aligned closely or were identical to the syllabi of the participating universities in the university training scheme. The PAAB also perpetuated a system whereby the JC and, after 1951, the PAAB itself, paid annual 'subventions' to universities to supplement the remuneration of full-time professors, lecturers, and senior lecturers in order to ensure that the best possible accountants would commit themselves to education of the new profession (PAAB, Annual Reports, 1951–1980; PAAB, Minutes, 23/09/52, 23/11/53, 13/05/54). When the PAAB aborted its intention to request approved universities to conduct the qualifying examinations (PAAB, Annual Report, 1958, p. 14; 1959, p. 14; 1960, p. 14), the accountancy profession embarked on an extensive investigation to establish the core elements required to secure a graduate accountancy profession (NC, Minutes, 17/03/66).⁴

The complexity and diversity of the services professional accountants were required to render increasingly called for a broad, catholic education, such as that provided by a degree in humanities, arts, or sciences, as core to the competency framework and profile of accountants. The PAAB called upon universities to devise academic avenues to assist students from degrees other than B.Com. degrees, to acquire the requisite subject credits necessary to enroll for the CTA. By 1964, most South African universities included one of the official languages, as well as economics, in the CTA program and provided avenues for postgraduate qualification toward the CTA within three years (PAAB, Annual Reports, 1959–1967). A Graduate Profession Sub-Committee of the National Council of the CSSA (NC) in 1966 led to the formation of the Common Body of Knowledge Committee (COBOK) investigation in 1967 to formulate the core common body of knowledge required by newly qualified accountants, as well as to define the knowledge and intellectual values newly qualified accountants would require to keep abreast of future developments, especially specialization. The committee also investigated the future relationship between the profession and the universities (NC, COBOK Report, 1969, p. 1). The report recommended that knowledge toward the accounting profession should be acquired on graduate level, that nongraduate candidates for the CTA should attend one year full-time at a university prior to the period of practical training, that consideration be given to the substitution of accounting degrees for the CTA, that greater emphasis to be placed on "positive" training of entrants to the profession in addition to the practical training, and that the PAAB supervise university education more closely and extend the quota of trainee practicing accountants under PAAB supervision.

These recommendations set the accountancy profession in South Africa on a sustained critical intellectual enquiry path into searching for best knowledge and best practice in accountancy. The NC had contemplated the development of the accountancy profession as a graduate profession since the mid-1960s (NC, Minutes, 22/03/66, 26/07/66), with the practical concern about the potential impact a graduate profession could have on the availability of clerks if all students pursued a graduate career path first (NC, Minutes, 22/03/66). The NC position paper on the accountancy graduate profession of July 1966 supported the development provided that the profession "maintain direct control over entry to its ranks and thus should continue to set the qualifying examination" (NC, Minutes, 26/07/66). In June 1967, the NC set in motion processes to establish a "professional standards committee" for accountants (NC, Minutes, 26/06/67).

Between 1970 and 1980, while attempts were made to consolidate the Provincial Chartered Societies, the NC led sustained accountancy knowledge and practice assessment innovation. The NC set up a Joint Task Committee with the PAAB Education Committee to advise the PAAB on the implementation of COBOK recommendations (PAAB, Annual Report, 1971, p. 8). The NC was the unmistakable driving force behind the Joint Task Committee until 1980. With regular intervals, changes to the CTA curriculum were proposed and implemented. Participating universities in the university training scheme introduced B.Com. Accounting degrees preceding the CTA, with some institutions awarding B.Com. (Hons.) degrees on the basis of successful completion of the subjects required for the CTA. The accountancy profession was elevated to a "graduate" profession as a result of the perpetual critical discourse within the NC about the challenges of the profession and the implementation of strategies to secure a leading position to South African CAs. A stronger collaborative relationship developed between universities on the one hand and the NC and PAAB on the other, which strengthened the knowledge base of the profession in a rapidly changing professional environment.

The NC extended its COBOK initiative by proposing the formation of a body to formulate new standards of accounting practice. The anticipated new Companies' Act of 1973 would require financial statements in conformity with "generally accepted accounting practice" (GAAP) on a basis consistent with that of the preceding year. The accounting profession was ultimately instrumental in having the phrase included in the Act, because it was "meant to allow for the development and improvement of financial reporting for which the investing public was beginning to be increasingly insistent" (SA Chartered Accountant, 1973, p. 426). The NC

thus established the Accounting Practices Board of South Africa (APB) in 1972. In conformity with the inclusivity of its conduct since the late 1940s, the NC included representatives of the NC, PAAB, the Johannesburg Stock Exchange (JSE), and leading bodies representing industrial, commercial, and mining interests on the APB (Loubser, 1980, p. 41; PAAB, Annual Report, 1972, p. 8). The Companies' Act of 1973 demanded annual financial statements to represent the financial position and the results of the company "fairly" and on a basis consistent with those of previous years. The NC decided to approach these new requirements not by new legislation, but to devise a consultative procedure for submissions on accounting practices, professional deliberations, and the formulation of a consensus position on GAAP. The NC set up the Accounting Practices Committee (APC), which received exposure drafts or accounting practices pronouncements. These were distributed among the profession, the JSE, and other stakeholders, which submitted comments to the NC. The NC submitted the responses and subsequent discussions to the APB, which made a final decision about acceptance and implementation of the proposed new rule(s). These proactive technical research activities led to another initiative, namely the establishment of the Accounting Development Foundation (ADF) to assist the APC. The affairs of the ADF were administered by the NC, but the ADF was controlled by three trustees. Its object was primarily to promote, commission and fund research, study and development of GAAP, as well as to promote the teaching of accountancy. The research function included research on standards of financial reporting for the benefit of the education of such technical innovations, for the benefit of users (investors) and auditors of financial statements and reports in South Africa. Involvement with accounting standards indicated the need also to review audit standards. In 1973, an Audit Standards Committee was formed by the NC to review existing statements on auditing (Loubser, 1980, pp. 46–47; NC, Annual Report, 1973, pp. 4–5).

International recognition for the leading role performed by the South African accounting profession came in the early 1970s. In 1973, the International Standards Committee (IASC) was established. The standards of technical developments in accounting in South Africa was internationally acknowledged, but since the country was in the throes of international sanctions and did not take part in the negotiations leading up to the establishment of the IASC (Camfferman & Zeff, 2007, p. 71; Kirsch, 2006, pp. 18–23), the NC was invited immediately after the formation of the body to become an associate member. Provision was made for the invitation of "associated membership" of the IASC, and South Africa was invited in

July 1974 to become an associate member of the IASC (Kirsch, 2006, pp. 48–49; NC, Annual Report, 1975, p. 4). In 1977, the IASC constitution was amended to provide for additional full membership of the organization and, in 1978, South Africa became a full voting member of the IASC. The international accountancy community held the South African profession in high esteem. Camfferman and Zeff (2007, pp. 71 and 175) noted that, “The South African delegation’s two voting members all came from major accountancy firms and typically were very senior and influential members of the National Council of Chartered Accountants (SA).” One of the South African delegates was J. A. Porteus, who was also the chairman of the APC, and it was noted that this level of expertise made South Africa eligible to become the second associate member (after Israel) to be elected to serve on the IASC project Steering Committee in 1974. It was the task of the Joint Steering Committees to draft the proposed international accounting standards (Camfferman & Zeff, 2007, p. 79).

Collaboration with the IASC contributed to the systematic development of South African GAAP (Loubser, 1980, p. 41). From the outset, the NC anticipated that, “Although the development, exposure and acceptance of [the Accounting Practices Committee’s and Accounting Practices Board’s] statements will continue as before, they will, so far as practicable, be developed in parallel with those of the IASC” (Porteus quoted in Camfferman & Zeff, 2007, p. 175). The accounting profession by means of the NC, in collaboration with the PAAB, developed accounting standards by the end of the 1970s, which positioned the accounting profession in South Africa in an international position of recognition. In 1979, the IASC conducted a survey of countries’ compliance with IASC standards and it was reported by the NC that the South African accounting standards could be considered to constitute “GAAP” (Camfferman & Zeff, 2007, p. 175). It was this alignment with IAS that made the later conversion of SA GAAP to IFRS relatively easy in 2005.

PROFESSIONAL CONSOLIDATION AND RESTRUCTURING

In the period from 1980, two important developments shaped the accounting profession in South Africa. The first was the organizational restructuring of the profession, and the second was the technical developments in accountancy following the requirements of the Companies Act, No. 61 of 1973 in respect of the reporting in terms of GAAP.

The accountancy profession had organized itself in provincial societies and, finally, in a Joint Council in 1945. The Joint Council was replaced by a National Council (NC) in 1966. The functions of the NC included the coordination of activities of the provincial societies, management of internal and external communication also with government, maintenance of standards of professional conduct, issuing statements on accounting and auditing matters, and conducting research into accounting, auditing, and related professional matters (NC Minutes: Constitution of the National Council of the Societies of Chartered Accountants of South Africa, 1966). The NC operated by means of committees, inter alia, an Accounting Practices Committee, an Audit Committee, an Education Committee, and a National Society Committee (NSC). The NSC was engaged in sustained investigations into the ultimate formation of a national body. A serious problem facing the profession was a shortage of manpower, and, thus, the training of accountants remained a critical matter of constant consideration. One way of addressing the matter was to centralize all efforts toward the promotion of the profession. The cumbersome structure of the profession called for rationalization. The PAAB, the NC, and provincial societies, alongside some regional societies, created an intricate network of consultation before action could be taken. In August, 1970, the NC appointed L. F. Bowsher to investigate the desirability of a national society of accountants of South Africa, but if he found the concept unacceptable, he was required to suggest strategies to improve the functioning of the existing structures. The Bowsher Report suggested that a national society was preferable, since it could strengthen the profession and overcome issues of provincialism, domination by densely populated regions, common interests across provincial boundaries, and differences in subscriptions (NC Minutes: Bowsher Report, 1971). The majority opinion of accountants was that a national body should be established, with retention of the provincial societies. More than 46% respondents even suggested the demise of the PAAB into a new national body (NC Minutes, Bowsher, 1971). The NC pursued the initiative by means of a National Institute Committee, which reported to the NC in July 1976. The concept was to form a national institute as a federal body with retention of the provincial societies. In 1979, all four provincial societies voted in favor of unification and were dissolved during an NC meeting in February 1980, with retrospective effect to January 1, 1980, when the South African Institute of Chartered Accountants (SAICA) commenced. This was the first unitary body representing all chartered accountants in South Africa (NC, Annual Report, 1979, p. 11; SAICA, Annual Report, 1980, pp. 4–5).

SAICA developed a powerful position as the primary representative organization of chartered accountants in South Africa and, via the APB, as the instrument of accounting standard setting in South Africa (De Villiers & Venter, 2010, pp. 7–8). During the 1970s and 1980s, the PAAB's relationship with universities was strengthened, while the PAAB was in full control of the qualifying examinations and the registration of auditors and articled clerks. Only SAICA members were allowed to register with the PAAB. SAICA had 6,824 members in 1980 and increased that number to 29,814 in 2010 (SAICA, Annual Report, 1980, 2010). Chartered accountants who were members of the Provincial Societies were permitted to become members of SAICA.

On January 1, 1980, shortly before the formation of SAICA, a Commission of Enquiry into Developments in the Accountancy Profession (jointly appointed by the NC and the PAAB in 1976) delivered its report (PAAB, Annual Report, 1976, 1980; SAICA, Annual Report, 1980). The Commission was critical of the dual structure of regulation in the accountancy profession, i.e., the existence of the PAAB alongside SAICA, commenting that, "This complicated structure ... has led to confusion in the mind of the layman, but more importantly, there is evidence of some duplication of effort and there is a need to present a unified front on the international scene" (SAICA Annual Report, 1980. Report of the Commission of Enquiry, para. 46). A merger of the two bodies seemed distant. The PAAB was a statutory body entrusted with the responsibility to protect the public interest and the financial interests of the people of the country. This was clear from the Minister of Finance's address at the first meeting of the PAAB in 1951, and remained a guiding principle of the Board. The voluntary society of accountants, SAICA, was a professional organization protecting the interests of its members and upholding professional standards, integrity, and the pre-eminence of the CA(SA) designation nationally and internationally. Growing functional divergence between the two institutions since the early 1990s resulted in a clear delineation of duties, responsibilities, and functions sanctioned by new statutes.

In 1991, a new Public Accountants' and Auditors' Act, No. 80 of 1991 was passed, which consolidated previous amendments to the 1951 Act and provided for the incorporation of audit practices (PAAB, Annual Report, 1991, p. 8). The PAAB commissioned research into the structure, scope, and content of education and training required for Chartered Accountants in South Africa – the "Future of Accounting Education in South Africa" project (FAESA). Far-reaching restructuring proposals for the accounting profession in South Africa by FAESA in 1994 solicited strong responses. The

Interim Representative Council of Accountants (IRC) was formed in 1995 to consider the FAESA proposals and draft legislation to that effect. An Accountants Profession Bill (APB) was delivered in 1997. The bill suggested the formation of a representative body for accountants and a similar body for auditors, with two independent standard setting bodies – one for ethics and one for auditing. The past issue of the existence of various associations and institutes representing accountants was resurfacing here, since the proposed representative body for accountants was perceived to regulate the access and mobility of the broad accounting profession in South Africa (comprising about 15 different organizations). This would undermine the status of SAICA and allow access to the profession, which the Chartered Societies and its representative bodies had attempted to control for purposes of professional standards since 1904. The strong responses from the chartered profession resulted in yet another forum to review the professional landscape. In 1998, the National Accounting Consultative Forum (NACF) was appointed to facilitate a consultative process to resolve the negotiations on professional restructuring. Consensus was that the APB of 1997 needed revision, but environmental circumstances, such as the international accounting and auditing scandals leading to the collapse of Enron, Worldcom, and Parmalat, delayed and diverted the revision process. In December 2002, the Minister of Finance appointed the Accounting Review Panel (ARP) to revisit the regulatory structure for auditors and accountants as well as the APB of 1997. The South African Government was clearly disturbed by the global accountability and ethical breeches and required the ARP to report on a wide range of matters pertaining to liabilities and accountability of auditors, the appropriateness and usefulness of accounting standards, and the connections between the statutes regulating the accounting profession, the financial reporting legislation, and the Companies Act of 1973 (PAAB, Annual Reports, 1997–2005; Puttick & Van Esch, 2007, pp. 8–111).

The Auditing Profession Act, No. 26 of 2005 (APA 2005), was passed to give effect to the ARP proposals. The APA 2005 came into effect in 2006 and returned to the focus of the 1948 Draft Accounting Bill submitted to the JC by Treasury, namely the regulation of the audit profession as the primary mechanism to “protect the public in the Republic by regulating audits performed by registered auditors” (APA, 2005, Sec. 2(a)). The APA 2005 repealed the PAA Act, No. 80 of 1991, and replaced the PAAB by the Independent Regulatory Board of Auditors (IRBA). IRBA subsequently was given the statutory duty to the education, training, and professional development of registered auditors, to accredit professional bodies, to register auditors, regulate their conduct, and develop and maintain

internationally comparable ethical standards and auditing standards to promote investment in South Africa (Puttick & Van Esch, 2007, p. 12; APA, 2005, Sec. 2(c), (d); Sec. 4(c), (d), (e); Sec. 5, 6, 7). The APA 2005 thus separated the regulatory framework of the audit profession from that of the accounting profession. In 1949, the JC argued very convincingly for the inseparable nature of these functions in the accounting profession, but, by 2006, both global corporate auditing scandals and domestic political developments, coupled with professional contestation between the PAAB and SAICA, resulted in the separation of the regulatory framework of the audit profession and the accountancy profession.

The audit profession was strengthened by the simultaneous passing of the Companies Amendment Act in July 2005. These amendments included that only registered auditors in terms of the APA 2005 may be appointed as an auditor of a company. Furthermore, all public interest companies had to have an audit committee comprising nonexecutive directors to ensure compliance with APA 2005 (Puttick & Van Esch, 2007, p. 13).

The professional accountancy function remained vested in SAICA. The Chartered Societies always claimed the right to self-regulation as the distinguishing characteristic of a profession. The Government intervention resulting in the PAA Act of 1951 left the profession no choice but to operate in a statutory-regulated environment. Upon the formation of SAICA, the president, R. B. Lobban, applauded the unity obtained through the formation of SAICA, but added: "It seems now that it is possible to remove what has hitherto been regarded as the major disadvantage, that is the fear that some members have of what they regards as Government interference" (SAICA, Annual Report, 1980, p. 4). In the last annual report of the PAAB, the chairman stated: "The promulgation of the new Auditing Profession Bill is intended to finally lay to rest the perception and reality of self-regulation by the profession with a more direct role in the regulation by the Minister of Finance and National Treasury" (PAAB, Annual Report, 2004, p. 3). Initiatives between SAICA and the PAAB since 1987 to find common ground on the structure and cost-efficiency of the two professional bodies finally failed in 1992, when the concept of "enforced commonality" was rejected. The latter implied that common executive committees of both the PAAB and SAICA on the grounds of "commonality" of interest and capacity, as suggested by "a sector of the profession" (PAAB, Annual Report, 1992, p. 8; 2005/06, p. 6). Close collaboration between the two bodies remained on matters of audit standards, but SAICA was representing its members in wider spheres than just the auditing environment. An increasing number of CAs chose to serve in commerce and industry as

chartered accountants. Between 1951 and 1998, 23,084 persons successfully completed the QE and thus qualified to use both the RAA and CA(SA) designations – but, by 1998, more than 4,500 CAs were outside professional practice. In 1998, the PAAB, as it was still the statutory body entrusted with the regulation of education, training, and assessment of the education programs of the professional institutes enabling qualifying as Registered Accountant and Auditor, agreed to recognize the academic, education, training and Part One assessment programs of SAICA. This implied that SAICA would compile (with the cooperation of the PAAB) the first part of the QE on accounting, financial management, audit, and tax specialism courses. These examinations were subsequently set and administered by SAICA, but “prescribed by the Board.” The PAAB continued to prescribe and control the second part of the qualifying examinations, which, from 1999, was called the PPE or Public Practice Examinations. SAICA also took control of the accreditation of universities with respect to its new authority in the QE. The restructuring of functions between SAICA and the PAAB resulted in education and training staff of the PAAB transferred to SAICA and the practice review staff from SAICA were transferred to the PAAB (De Villiers & Venter, 2010, p. 8; PAAB, Annual Report, 1998, p. 10; 2005/6, p. 7). This position has been retained by 2007 – IRBA sets and administers the PPE.

TECHNICAL DEVELOPMENTS

During the period since the formation of the APB, the APC, the ADF, and the ASC in the early 1970s, the NC and later SAICA developed a technical accounting and auditing standards framework which constituted South African GAAP. The APB issued the first statement of GAAP in 1974, “The disclosure of accounting policies.” The second statement was issued in February 1975 on “Taxation in the financial statements of companies” (NC, Annual Report, 1975, p. 4). The APC continuously investigated further accounting statements and issued exposure drafts on such accounting statements, and, once due weight had been given to comments and responses to the exposure, the APB issued GAAP statements, which gradually constituted a framework of accounting principles that constituted South African GAAP. The SA GAAP accounting principles took shape under the technical supervision of the NC and later SAICA. This process of compiling SA GAAP was hampered by the lack of a single conceptual framework which could serve as a point of reference when confronted with contentious

matters. The AC000 statements, first issued in November 1990, went a long way toward enlightening the technical developments of AC100 statements. The APB attempted to enhance acceptability of AC100 statements and therefore allowed much time for comments, revision, and redrafting of statements through a process of consultation, resulting in a slow generation of such statements. Maximum buy-in of stakeholders was seen to be vital to compliance. The documentation that evolved, which those responsible for the preparation of financial statements could rely on, consisted of the following:

AC 000 – The Accounting Framework, issued by the APB. This was only the one framework statement.

AC 100 – Statements of Generally Accepted Accounting Practice, issued by the APB. These were a series of statements.

AC 200 – Accounting Guidelines, issued by the APC.

AC 300 – Accounting Opinions, issued by the Accounting Issues Task Force (AITF). These “opinions” were succeeded by AC300 and SAC400 interpretations of accounting issues by 2003/2004 and by 2005 supplemented by AC500 statements, which were specific statements unique to South Africa (SAICA, *Year book*, 2003; SAICA, *Year book*, 2004; SAICA, *Year book*, 2005).

The accounting guidelines were issued on thorny matters in order to provide timely guidance on how to deal with such matters and thereby prevent undesirable practices spreading. The accounting opinions were issued to provide guidance on matters which required reviewing or were treated differently in practice. The AC 300 opinions aimed to “provide authoritative guidance to preparers, auditors and users of financial statements thus facilitating the standardization of accounting treatments” (Everingham & Watson, 2000, pp. 1–2).

In a similar fashion, the NC established the Audit Standards Committee (ASC), which researched audit standards. In 1975, the ASC issued the first exposure drafts on audit standards, “Auditing Standards,” “General standards of auditing,” and “Standards of field work.” The formulation of audit standards was performed by the NC, and later SAICA, while the PAAB had a direct input by means of the chairman of the ASC, who acted as the representative of the PAAB. Nevertheless, the PAAB formed its own Audit Standards Board (ASB) in 1999, which was formed in anticipation of the Accountancy Profession Bill being passed. While the legislative review process was pending, the PAAB ASB, consisting of representatives of the Auditor-General, Financial Services Board, the JSE, the South African

Chamber of Business, the Department of Trade and Industry, and the PAAB, requested SAICA's ASC to continue with its harmonization function in terms of audit standards. The ASC functioned as a working committee of the ASB (PAAB, Annual Report, 1999, p. 10). In 2004, when the APA was almost passed, the PAAB established an Auditing and Assurance Board (AASB), under the chairmanship of Prof. S. P. Kana (CA)(SA). In actual fact this development was disclosed as the ASB subsumed the ASC to form the AASB (PAAB, Annual Report, 2004, p. 8).

The accounting profession in South Africa has been pro-active in developing technical accounting and audit standards since the COBOK Report. Via its international participation in various organizations, such as the IASB, IFAC (since 1977), the International Audit Practices Committee and its successor the International Audit and Assurance Standards Board (IAASB), the profession has also positioned accounting and audit practice in South Africa closely to the international benchmark. SAICA, the JSE, and the APB realized how important international financial reporting compliance was, especially for a country wishing to re-enter the global economy. The adverse emerging market crisis of 1998 underlined the necessity of a financial system's ability to demonstrate maximum reliability, which lies in the transparency and accessibility of dependable information in financial statements. These developments convinced the APB of its direction to align SA GAAP increasingly with the international accounting framework (Everingham & Watson, 2000, pp. 1–7). Since 1993, the APB followed a conscious strategy of harmonization of SA GAAP with international accounting standards. This strategy positioned financial reporting in South Africa closely with international standards. The JSE could require listed companies since October 2000 to prepare annual financial statements to comply with the national law applicable to listed companies (the Companies Act) and either SA GAAP or IAS. The JSE revised its listing requirements again in 2004 to request listed companies compliance with IFRS from January 1, 2005. The next step by the APB was therefore in February 2004 to issue the text of IFRS as SA GAAP "without amendments." Coetsee explained the option to listed entities as an attempt to assist dual listed companies (Coetsee, 2007, pp. 3, 5, 7; see JSE Listing Requirements, Sec. 8.62(b)). The motivation for this move was "for South African companies to attract foreign investment to provide credibility to the financial statements of South African companies in the global market; and to do away with the need for dual listed entities to prepare financial statements in accordance with more than one set of accounting standards" (Ludolph, 2006).

South Africa was one of the first countries in the world to implement the IFRS. Whereas the accounting profession in South Africa, accounting principles and company law had been closely influenced by developments in the United Kingdom since the 19th century, the profession, through its organizational structures and technical focus, together with statutory developments, developed an independent South African character. Despite this, the profession maintained strong links with the Commonwealth and, since the formation of the IASB, with international accounting developments. The convergence of SA GAAP to IFRS followed without too much technical adjustment because of the quality of APB-developed statements and the sustained international connectedness of the South African accounting profession.

CONCLUSION

The accounting profession in South Africa has always been a proud profession. This is a brief glance over this history. The Chartered Societies protected the professional status and standing of the profession. The maintenance of high standards of technical expertise, professional conduct and professionalism served to ensure professional closure. The profession was dominated by males from European descent, but SAICA and the PAAB, later IRBA, have embarked on education programs and learning support systems to assist access by a wider community of South Africans formerly not interested in the profession or unable to succeed in the stringent professional training. Since the 1980s, SAICA established the Eden Trust to encourage and assist people of African and colored population groups in qualifying as accountants. The education programs were subsequently formalized in the Thuthuka Programmes for scholars from rural and disadvantaged backgrounds to offer tuition assistance toward success in accounting training at a South African university. The scope of access into the profession was also widened by the accreditation of Chartered Institute of Management Accountants (CIMA) and ACCA qualifications for alternative careers in accounting. This development occurred since the early 1990s, and, by 2007, has gained substantial momentum. After 2007, various initiatives were taken to broaden the scope of access to accounting practitioners on different levels of accounting practice, such as non-CA accounting technicians organized in the South African Institute of Public Accountants (SAIPA). This is an ongoing professional development process driven by SAICA and IRBA.

NOTES

1. Art. 6 of the Accountants Ordinance stated unequivocally that members of the following associations were entitled to register as a public accountant in the Transvaal: Society of Accountants and Auditors of England; Society of Accountants of Edinburgh; Institute of Accountants and Actuaries of Glasgow; Society of Accountants in Aberdeen; ICAEW; Institute of Chartered Accountants in Ireland; and Society of Accountants and Auditors in England. Furthermore, any person who was “*bona fide* practising as a Public Accountants in the Transvaal” would be allowed to register on the initial register of the TSA. The Transvaal Government acted to achieve optimal inclusivity in the profession.

2. In the United States, the collaboration between universities and the profession only gained momentum after the Vatter Report in 1964 and in the United Kingdom after the Robinson Report on Higher Education in 1963.

3. A consolidation of representative associations of accountants and auditors manifested in the course of 1958. The SIAA was integrated into the ICAEW in 1957 and therefore its South African branches were liquidated. The SIAA South African branches' representation on the PAAB in terms of Sec. 3(2) of the PAAB Act was therefore ended. The South African branches of the Association of Certified and Corporate Accountants, as well as the Association of Public Accountants of South Africa, dissolved. The last two associations reached an agreement with the Chartered Societies' JC in terms whereof a large number of the practicing accountants of the former bodies were accepted as members of the Chartered Societies. Although separate statutory representation on the PAAB was terminated, those accountants enjoyed representation through their membership of the Chartered Societies in the PAAB. This development strengthened the position of the Chartered Societies (PAAB, Annual Report, 1958, p. 10; TSA, Minutes, p. 27/01/61).

4. The Joint Council of the Chartered Societies changed its name to the National Council of the Chartered Societies in 1966.

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CHAPTER 7

TURKEY

Yüksel Koç Yalkın and Volkan Demir

INTRODUCTION

The Republic of Turkey, which was founded in 1923, celebrated the 88th anniversary of its establishment on October 29, 2011. Although it is still a young country, the economy grew rapidly and, more recently, it became one of the largest developing countries. If the growth rate of the economy continues to rise, it will not be difficult to become a developed country in the coming years. Parallel to this development within the economy, areas such as accounting, financial reporting, and auditing are constantly evolving. In 1989, the accounting profession gained its legal status and professional chambers and associations were then established. Since 1989 until today, the accounting profession has experienced a very rapid change and development. In addition, the accounting profession and accounting research in the country has become more popular and has shown great improvement. With time, professional accountants and the Union of Chambers of Certified Public Accountants and Sworn-in Certified Public Accountants of Turkey (TÜRMOB), as well as the government authorities, better understood the importance of accounting, and legal innovations were made in this regard. The new Turkish Commercial Code (TCC) is an example. As of January 1, 2013, all listed and non-listed companies will be required by this law to prepare and present their financial statements in compliance with Turkish Financial Reporting Standards (TFRS), which are Turkish versions of International Financial Reporting Standards (IFRS). Also, independent

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audits will become mandatory. Under this law, the difference between listed companies and non-listed companies in terms of accountability and transparency will be eliminated and all companies will be required to apply corporate governance principles.

In recent years, Turkey has organized important accounting congresses, such as the 17th World Congress of Accounting, 12th World Congress of Accounting Historians, and 33rd Congress of the European Accounting Association. Furthermore, dozens of accounting, auditing, accounting education, and accounting standards symposia are regularly held by universities and professional chambers.

In addition, Turkish accounting academicians established professional organizations, including the Accounting Academicians' Collaboration Foundation (MODAV), the Accounting and Finance Academicians Research Association (MUFAD), and the Association of Accounting and Finance Historians (MUFTAD), in order to follow global developments and to publish refereed journals. These journals are scanned by substantial indices in Turkish and English.

Capital markets in Turkey have not yet fully broadened the capital base. Today, only 367 companies are traded on the Istanbul Stock Exchange (ISE). However, as the Capital Markets Board (CMB), the ISE and the government encourage companies to trade their stocks on stock exchange markets, it is expected that the number of listed companies will rise to approximately 1,000 within a few years. All these developments will further increase the importance of accounting and financial reporting, and investors will have the opportunity to evaluate companies by analyzing their financial statements.

THE HISTORY OF ACCOUNTING IN TURKEY

Upon examination of Turkey's history, it can be said that accounting began to be applied integrally with governmental accounting. Turkish governmental accounting dates back to very old times. The documents found indicate that the governmental accounting idea existed in the foundation of the Ottoman Empire. The first accounting regulation discovered before reaching the current governmental accounting practice, dates back to 1880. The accounts kept throughout this accounting regulation are based on a cameral accounting system. In 1909, the budget of constitutional monarchy was adopted and a new accounting system was established. This system was

also a kind of cameral system. In this regulation, the expressions of “debit” and “credit” were used without mentioning a name (Akarçay, 1980, p. 29).

It can be said that detailed and reliable bookkeeping activity existed in public units in the Ottoman Empire era. However, until the 20th century, accounting and auditing activities remained limited in private sector entities, most of which were family businesses (TÜRMOB, 2000). In fact, development of accounting practices in Ottoman Empire was affected by both the developments in the economic environment of the country and the practices in many Western countries due to economic and political bonds. For example, the first Commercial Code, dated 1850, which was prepared in order to shape commercial life, is a translation of the French Commercial Code. This code is also regarded as the first accounting regulation in Turkey (Öker, Demir, & Perek, 2009, pp. 317–318). Furthermore, as the country had very strong economic and political relationships with France in this period, the academicians working on accounting and tax received their education in France (Bursal, 1984). All of these developments show that the French effect prevailed in accounting practices in Turkey in the 19th century.

The political environment of the Ottoman Empire went through a change at the end of the 19th and beginning of the 20th century, and the empire intensified its commercial relations, especially with its ally Germany, such that it is seen that a large part of some 215 private sector entities in the country was controlled by German and French entrepreneurs until World War I (Muğan & Akman, 2010, p. 24).

The State of the Republic of Turkey was founded under the leadership of Mustafa Kemal Atatürk upon the demolishment of the Ottoman Empire following World War I. Atatürk fought against imperialist capitalism in order to found an independent country and adopted a controlled market economy model instead of a socialist economy (Walsted, 1980). The Republic, under its controlled market economy, adopted a double accounting system for recording and reporting the economic transactions which would be carried out by entities. The accounting practices in Turkey were affected by economic and political circumstances as well as the practices of many Western countries of this time (Yalkın, 2006, p. 11).

Upon the foundation of the State of the Republic of Turkey, the influence of Germany, Ottoman Empire's ally in its last period, in commercial life continued. During this period, the influence of France, which was challenge in World War I, on the commercial life of the country decreased. This situation gave rise to the replacement of the Commercial Code based on the French Commercial Law (dated 1850) with a new Commercial Code based

on the German Commercial Law in 1926. The accounting rules within this Commercial Code were naturally taken from German accounting practices.

On the other hand, the state assumed responsibility for establishing heavy industry entities due to the small number of private sector entities and capital insufficiency in the private sector in the first years of the Republic. In 1993, when Sümerbank came into operation, the establishment period of State Economic Enterprises (SEEs), which are the most important cornerstones of the economic growth plan, began (Öker et al., 2009, p. 318). Sümerbank was assigned the task of processing natural mines that were nationalized and taken away from foreign companies. Again in this period, Turkey accepted many German academicians working in various fields as guest faculty members in its own universities. For this reason, financial and cost accounting practices of SEEs were shaped as a result of doctrines of guest German academicians. Sümerbank and SEEs was to contribute to the development of the private sector. German influence of these entities in accounting systems was also reflected on accounting practices of private sector entities over time (Muğan & Akman, 2010, p. 25). However, these economic developments were interrupted by World War II.

An accounting team was formed within the Ministry of Finance in 1945 for the purpose of auditing accounting records in taxation terms. This team conducted many audits on behalf of the Ministry within the framework of the first tax laws having entered into force in 1950. Between 1920 and 1950, Turkey's economy demonstrated a conservative structure and government intervention was at the forefront in economic activities. Between 1950 and 1960, when international trade gained speed, the first steps for liberalization were taken in the Turkish economy. The Commercial Code dated 1956, which is still in force today, was prepared parallel to these economic developments. Turkey was accepted as a candidate in the European Economic Community in 1959 (Öker et al., 2009, p. 318). Furthermore, economic developments such as both the Bretton Woods conferences which emerged in the world economy following World War II and the transition to multiparty political life in 1946 affected the Turkish economy and policies and enabled the beginning of a liberalization movement, even if in a limited way. In 1950, the Turkish Industrial Development Bank was established for the purpose of financing private sector investments with the support of the World Bank.

Incentives were provided for the private sector and foreign investments; American experience was used in the private sector and the economic system of the country came under the influence of the American system in the 1950s. During this period, funds were borrowed from the United States, within the scope of the Truman Administration and Marshall Plan, and two

Turkish universities that provide education in English, the Middle East Technical University and Boğaziçi University, adopted an education program which contained theoretical and practical approaches to the accounting system. Furthermore, students were sent to foreign countries, notably to the United States in this period, and the influence of American schools increased in the accounting system upon the return of these students to Turkey. American influence is seen clearly in the uniform chart of accounts drawn up for public entities in 1974 (Öker et al., 2009, p. 319). Another result of the liberal economy policies pursued in the 1950s was the augmentation of industry, trade, and service entities in the private sector in terms of both quantity and quality and the associated increased necessity for the accounting profession in parallel (Güvemli, 2001, p. 44).

At the beginning of the 1950s, the economy had grown more than ever before, but the balance of payments was disrupted in Turkey, as well as the international trade balance, which was disrupted in late 1950s, and an economic crisis period began. Agreement was reached with the International Monetary Fund (IMF) on the financial stability program in 1958 as a result of this crisis (Muğan & Akman, 2010, p. 25).

A military coup occurred in Turkey in 1960 and a planned economic structure was introduced in the period following the coup. A five-year development plan, prepared in 1963, was implemented successfully within the scope of the planned economy, and growth was achieved in many sectors, notably in agriculture, industry, and service. Although the economy was open to government intervention during this period, government interventions created the appropriate conditions for entrepreneurs to save capital. Incentives such as accelerated amortization, investment allowance, and exemption from custom tariffs and expenses were put into practice at this time. However, in the late 1960s, increased public expenditures as a result of the effort to be successful in elections caused the Turkish economy to again come under pressure. On the other hand, another military coup occurred in the early 1970s and increases in oil prices in 1973 and 1974 rendered the country unable to pay its debts. Due to the disrupted economic situation, the country was dragged into a new chaos and the third military coup in country's history occurred in 1980 (Muğan, 1995). The government established following the coup received funds from the World Bank and the IMF for the purpose of decreasing inflation and increasing production and export, and, in return for this, it put a series of liberal policies recommended by the IMF into effect.

A restructuring period started in the first half of the 1980s and Law No. 2499, which would lay the groundwork for the establishment of capital

markets, was enacted. In 1984, regulation was made for the establishment of the ISE and its activities commenced in 1986. The establishment of the CMB and ISE, together with increased foreign investments, created an obligation to develop accounting and auditing standards. Furthermore, the increase in joint ventures and foreign trade enabled the "Big Eight" accounting firms to open offices in Turkey. As a result of these developments, large private entities began to publish financial statements, which were in compliance with international accounting standards as well as the financial statements that met national reporting requirements (Muğan & Akman, 2010, p. 26).

The first set of financial accounting standards in Turkey were developed by the CMB in 1989, and these standards entered into force as of January 1, 1989 (Öker et al., 2009, p. 321). However, the people and companies in the CMB used TFRS, which is a direct translation of IFRS.

As explained above, accounting practices in Turkey were affected by various processes. However, it can be said that accounting principles are considered equivalent to tax accounting and, for this reason, accounting principles do not develop as accounting practices do. At the beginning of the 1940s, despite the foundation of the Turkish Expert Association, the accounting profession was not regulated through any law until 1989. Regulations were made with regard to the accounting profession through the law enacted in 1989, and accounting principles were published by the Union of Chambers of Certified Public Accountants of Turkey in the 1990s. The primary reason for this delay was the absence of any grounds for public, audited, and comparable financial statement regulations of Turkish entities, most of which are family businesses. Accountants in family businesses usually undertook duties such as recordkeeping for tax purposes, cash management, budget preparation, and regulation of financial statements in compliance with tax legislation (Muğan & Akman, 2010, p. 27).

The Ministry of Finance established a committee in order to develop the accounting principles and a uniform chart of accounts in 1992. The Ministry published the committee's report through a communiqué in 1992, and the uniform chart of accounts entered into force in the period starting from January 1, 1994. All companies, except banks, brokerage firms, and insurance companies, are obliged to follow the guide in the communiqué (Muğan & Akman, 2010, p. 26).

In February 1994, the Turkish Accounting and Auditing Standards Board (TAASB) was founded in order to develop accounting and auditing standards, which would ensure preparation and presentation of consistent financial statements. TAASB has adopted the following principles for

developing national accounting standards (TÜRMOB, 2000, p. 5; <http://www.turmobil.org.tr>, accessed on January 30, 2012):

- (a) Accounting standards to be developed shall be in compliance with international accounting standards.
- (b) Structures and requirements of the entities within the country shall be taken into consideration during the process of standard development.

TAASB developed 19 accounting standards which were published by TÜRMOB as Turkish Accounting Standards (TAS). However, such standards were not widely implemented by the entities. The Turkish Accounting Standards Board (TASB), which was established under the Ministry of Finance, replaced the TAASB in 1998. TASB conducted its first meeting in 2002 and translated IFRS into Turkish. On the other hand, both the Banking Regulation and Supervision Agency (BRSA) and the CMB made the implementation of accounting standards published by TASB compulsory. However, the CMB requires entities to implement the standards as they were adopted by the European Union (Muğan & Akman, 2010, p. 27). Turkey remains a candidate country since the application for EU membership (previously EEC) in 1959.

LEGISLATIONS

Entities in Turkey draw up their financial statements in compliance with tax laws and commercial codes. On the other hand, banks, insurance companies, brokerage firms, and public companies apply laws and regulations prepared exclusively for such entities while drawing up their financial statements. Until recently, the authorities making regulations on accounting looked out for their own interests rather than providing information for the users of the information. Due to this accounting executors had to implement tax accounting while drawing up financial statements (Bursal, 1984). However, as a result of external factors such as movements in global capital markets and the EU membership of Turkey, as well as pressures from interest groups in the country, many regulations have been made in the field of accounting. Laws regulating activities in the field of accounting can be considered as tax laws, commercial codes, capital markets law, and communiqués related to law, occupational act, and accounting system application general communiqué No. 1.

Tax Laws

Tax laws include basic taxation principles; explanations related to these principles are made in the communiqués published by the Ministry of Finance. The basic tax laws in Turkey are the Income Tax Act, Corporate Tax Law, Value-Added Tax Act, and Tax Procedure Law.

Income Tax Act

Income tax is a direct tax levied on the income earned by natural persons within a financial year. It can be said that the Income Tax Act, which entered into force in 1961, also aims to achieve justice in income distribution as the act contains a progressive tariff. According to the regulation in the act, tax is levied on the source by deducting from the incomes of the employees, and the incomes of traders and self-employed individuals are taxed as per accrual and declaration. Tax brackets include rates ranging between 15% and 35%.

Corporate Tax Law

Corporate tax is levied on the incomes of companies, cooperatives, public enterprises, economic enterprises of associations and foundations, and business associates. The Corporate Tax Law, which was renewed in 2006, sets the tax rate for all entities at 20%.

Value-Added Tax Act

According to the Value-Added Tax Act, which entered into force after being published in 1984, all goods and service deliveries related to commercial, industrial, and agricultural activities incur value-added tax (<http://www.gib.gov.tr>, accessed on January 30, 2012). Value-added tax is generally 18%, despite different tariffs for different goods and services. The Value-Added Tax Act increased the need for the accounting profession in the country as it requires taxpayers to make declarations monthly.

Tax Procedure Law

The basic concepts and detailed explanations related to such matters as taxation, valuation, and tax penalties are contained in the Tax Procedure Law, which entered into force after being published in 1961. The law directly

concerns the accounting profession. After the Act entered into force, communiqués related to accounting practices based on basic principles in the Act were published. Many accountants in Turkey carry out their activities in compliance with the communiqués prepared according to or based on this Act; however, independent auditors must comply with the regulations made by the CMB and the BRSA.

Turkish Commercial Code

Developments in international trade, technological advancements, and EU membership of Turkey made it obligatory to amend the Commercial Code of 1956. It is anticipated that the new Commercial Code, which became law in 2011 and will come into effect in 2013, will make a significant contribution to the economic development of the country.

Even though accounting is considered as a source in terms of tax practices in Turkey, such perception has, however, begun to change after the new Commercial Code was published. The new Commercial Code assigned TASB the task of publishing financial reporting standards on the preparation of financial statements to the TASB which, as mentioned previously, translated IFRS and published them as TFRS. On the other hand, the new Commercial Code began the process of transition to IFRS in Turkey by requiring all companies, whether they are public or not, to report their financial conditions and financial performances in compliance with TFRS (Yalkin, Demir, & Demir, 2007). Moreover, the Code categorized the entities as small-, medium-, and large-scale entities according to criteria such as the size of assets and sales and the number of employees, and set different auditing requirements for entities in each category. Thus, independent auditing, which was compulsory for public companies, was extended and made compulsory for all entities.

Capital Markets Law

After the Capital Markets Law entered into force in 1981, the CMB was established to regulate capital markets and publish communiqués as per the Law. Parallel to the developments in international capital markets and global economies, the Capital Markets Law and the communiqués published by the CMB according to it have been amended many times since 1981.

Under the authority given by the Capital Markets Law, the CMB has published numerous communiqués on the preparation and auditing of financial statements perspicuously. The published communiqués were

repealed in the course of time as the needs disappeared, and, today, two important communiqués regulating accounting and auditing practices in capital markets have remained in force.

Communiqué Serial: XI, No. 29

This communiqué, published in 2008, made it compulsory for all public entities to publish their financial statements in compliance with IFRS (or TFRS) with effect from January 1, 2008. Articles 1 and 5 of the communiqué provide as follows:

Article 1 (Purpose): The purpose of this communiqué is to determine the principles, procedures and fundamentals related to the preparation and presentation of financial reports by entities with the purpose of ensuring the timely, sufficient and accurate communication of information to the public

Article 5 (Standards): Entities apply IAS/IFRS as adopted by EU and disclose the fact that they prepare their financial statements according to IAS/IFRS as adopted by EU, in their notes to financial statements. In this context, the TAS/TFRSs, which are not in contradiction to adopted standards, published by TASB are taken as the basis ...

Communiqué Serial: X, No. 22

The CMB published this communiqué on June 12, 2006. The purpose of the communiqué is stated in the first article as follows:

The purpose of this communiqué is to determine the standards, principles, procedures and fundamentals related to independent audit activities in the capital market, the independent audit firms that will be authorized by the CMB to perform these activities and independent auditors

This communiqué takes international standards on auditing as a basis. The CMB has made it obligatory to apply international standards on auditing for the audit of companies operating in the capital market and their associates and partnerships. The board has the authority to penalize companies, independent audit firms, and independent auditors who act in contradiction to this communiqué.

Accounting Profession Act

Compared with professional regulation in developed countries, professional law in Turkey was prepared and entered into effect later than in other

countries. The law profession is one of the most important steps of improvement in accounting profession. Trade bodies that were established within the framework of this law contributed to the international adaption process of the accounting system in Turkey by initiating cooperation with international organizations (Arıkan, 2006, p.2; <http://www.istanbulsmm-modasi.org.tr>, accessed on January 30, 2012).

The accounting profession obtained its legal status with Law No. 3568 on Certified Public Accountancy and Sworn-in Certified Public Accountancy published in 1989. The objectives of the law are set out in its first article (Arıkan, 2005):

[T]o ensure healthy and reliable functioning of the operations and transactions in enterprises, to present the actual facts to the use of the concerned persons and authorities objectively by auditing and evaluating the results of the operations within the framework of the relevant legislation, and to regulate the fundamentals concerning the establishment, organization, operations, activities and elections of the principal organs of Certified General Accountancy, Certified Public Accountancy and Sworn-in Certified Public Accountancy and the Chambers of Certified Public Accountants and Sworn-in Certified Public Accountants in order to materialize high professional standards.

Accounting System Application General Communiqué No. 1

The Ministry of Finance published a communiqué in December 1992 in order to ensure that all entities in the country draw up accurate, reliable, and comparable financial statements. The basic financial accounting concepts and principles were explained in the communiqué, which was called "Uniform System of Accounts." Moreover, it promulgated an accounting chart (uniform chart of accounts) that is compulsory for all entities to implement. The objective of the communiqué was set out in its first article:

This regulation is made in order to provide a true and fair accounting of operations and results of enterprises and companies owned by legal and real entities that keep accounting records on a balance sheet basis; to secure a fair reflection of the information presented to the interested parties through financial statements; by maintaining the consistency and comparability of that information and to facilitate the audit of these firms.

After the uniform chart of accounts entered into effect on January 1, 1994, a new era began in the accounting practices of the country. Besides being a guide for the preparation and presentation of financial statements, the communiqué also regulates the basic concepts and principles of accounting. This regulation aims to provide a true and fair accounting of

operations and results of entities by designating criteria for each transaction. The basic subjects in the regulations are:

- (a) basic concepts of accounting;
- (b) explanations on accounting policies;
- (c) principles of financial statements;
- (d) preparation and presentation of financial statements; and
- (e) framework of uniform chart of accounts, the chart of accounts, and Explanations.

Classifying the entities in Turkey in order for them to determine the legal legislation while preparing financial statements would be appropriate. The nonpublic entities which are considered as small scale are only obliged to be in compliance with the basic concepts of accounting while preparing financial statements. On the other hand, nonpublic entities which are considered as large scale are liable to the uniform system of accounting and provisions on accounting of the Tax Procedure Law. Public entities, banks, and insurance companies prepare financial statements in accordance with the Tax Procedure Law, as well as the communiqués published by CMB and Bank Regulatory and Supervisory Board, which are specifically published for them.

As can be seen, there are significant differences between the companies in Turkey in terms of accounting rules that have to be obeyed. As explained above, TASB was founded in 1990 as the sole authorized body with the duty of preparing and publishing accounting standards in order to eliminate these differences. Starting operations in 2002, TASB published its conceptual framework text and 38 standards, and 21 interpretations, which were translated from IFRS, in the *Official Journal*. With the enactment of the new Commercial Code, the disunity of accounting practices in the country was removed and all entities were imposed with the obligation of complying with the standards published by TASB.

INSTITUTIONS

Currently, the main institutions in Turkey that have the authority to make regulations about accounting and auditing are the Ministry of Finance, the CMB, the Bank Regulatory and Supervisory Board, and the TASB. However, the new Commercial Code gave authority to publish accounting standards to the TASB. The board continues its work within the framework of its authority.

Ministry of Finance

Regulations issued by the Ministry of Finance take precedence over all other accounting regulations, except for certain limitations relating to banks and insurance companies, which are subject to the Bank Regulatory and Supervisory Board and the General Directorate of Insurance. As explained above, the Ministry of Finance published the General Communiqué on Accounting System Application on January 1, 1994, by exercising the power granted by the Tax Procedure Law, and it has continued to publish communiqués related to accounting practices. The basic accounting concepts and uniform chart of accounts, which every entity is obliged to implement, are included in a total of 14 communiqués that are in force (<http://www.gib.gov.tr>, accessed on January 30, 2012).

Capital Markets Board

The CMB was founded in 1981 with the enactment of the Capital Markets Law. Being a public institution, the board continues its activities with absolute administration authority in its area of responsibility. It is composed of seven members who are appointed by the Council of Chairmen. Entities and other institutes that wish to operate in capital markets, as well as independent auditing firms, need to obtain approval from the board (<http://www.cmb.gov.tr>, accessed on January 30, 2012).

According to the Capital Markets Law, the CMB has regulatory authority in determining the principles of reporting and auditing related to financial statements of companies that are listed on the ISE, as well as banks and insurance companies. The ISE was established in 1985 under the supervision of the CMB and, with a market value representing approximately 44% of the Turkish gross domestic product of Turkey, can be said to be very important for the national economy and international relations of the country (<http://www.imkb.gov.tr>, accessed on January 30, 2012). The ISE is a member of the World Federation of Exchanges, the Federation of Euro-Asian Stock Exchanges, the International Capital Markets Association, and the European Capital Markets Institute. As of 2011, stocks of 367 companies are traded on the ISE.

Banking Regulation and Supervisory Board

The financial crises in November 2000 and February 2001 have necessitated readjustment in the banking sector of Turkey. The BRSA was established

within the scope of the Banking Law in order to allow banks and other financial institutes to operate in a more efficient way. Since 2002, the Turkish banking system has overcome the effects of the financial crisis, and, by 2004, it reached a more powerful structure (BRSA, <http://www.bddk.org.tr>, accessed on January 30, 2012). With an increased environment of confidence, the share of foreign banks in the country increased as well.

The Bank Regulatory and Supervisory Board provides license to financial institutes that want to operate within the scope of the Banking Law and open up a branch, and to independent auditing firms for the independent auditing of these financial institutes. The organization is a regulating body that protects the rights of depositors and secures the activities within the Turkish banking sector. For this purpose, the organization published a communiqué on November 8, 2006, and made it mandatory for all banks and other financial institutes to prepare their financial statements in accordance with TFRS with effect from 2006 (Yalkın et al., 2007). The beginning of the implementation of TFRS in the banking sector, where international activities are extensive, can be considered as an important step, particularly in light of the process of harmonization between Turkey and the European Union (POAASA, <http://www.tmsk.org.tr>, accessed on January 30, 2012).

Turkish Accounting Standards Board

TASB was established in 1999. As per an article added to the Capital Markets Law, TASB entered into service as a public institute with its own administrative and financial autonomy under the Ministry of Finance. The board held its first meeting on March 7, 2002, at which it set out its main objectives as: (i) preparing the conceptual framework that will be the baseline when publishing accounting standards and (ii) creating the draft of TAS that shall be declared to the public and will develop accounting standards that shall help to create safe, consistent, and comprehensible financial information in line with this purpose. The board also adopted a harmonization with IFRS. On the other hand, implementing internationally accepted accounting principles at a time when the EU membership process started is an element that is seen as making the integration of the Turkish financial system with the European Union easier (Demir, Kaya, & Levent, 2008). Thus, the TASB translated IFRS and published them as TFRS.

As a result of this work, there are 29 TAS and 10 TFRS, as well as TFRS for SMEs that were published by the TASB. These standards have been in

force since 2006; however, they are not mandatory for entities, except for banks, financial institutions, and exchange markets. However, as mentioned previously, with the enactment of new Commercial Code in 2013, these standards shall be mandatory for every entity. The order and number of TAS and TFRS are the same with International Accounting and Financial Reporting standards.

Turkish Auditing Standards Board

The Turkish Auditing Standards Board was established by the Union of Chambers of Certified Public Accountants of Turkey in 2003 as an institution that has financial and administrative autonomy. Composed of 15 members, the objective of this board is to prepare national auditing standards for the auditing activities that members of a profession, who obtained license according to the Profession Law, shall carry out (Arıkan, 2006, p. 48). Immediately after its establishment, the board commenced the work of translating the international auditing standards published by the International Auditing and Assurance Standards Board into Turkish. The standards in question were published by the Union of Chambers of Certified Public Accountants of Turkey. At present, however, this translation is not up to date, but the board is continuing its activities to update the set of auditing standards. When the new Commercial Code comes into effect, all companies shall be mandatorily audited by auditing standards that are in full compliance with International Auditing Standards starting from January 1, 2013.

LATEST DEVELOPMENTS

New Turkish Commercial Code

The Turkish Commercial Code No. 6102 (TCC) was published in the *Official Gazette* dated February 14, 2011 (No. 27846) and, since then, has drawn the attention of all members of the accounting profession to this law. As is known, this draft law lingered on the Parliament agenda for approximately six years, and when hopes for its enactment were almost given up, it was finally approved by the General Assembly of the Grand National Assembly of Turkey and became law.

While the new TCC brings fundamental changes to business life, it also attempts to catch up with the requirements of this era and clears the way of business life in many subjects, such as, inter alia, information systems, the Internet, and e-notebooks. While this law, in essence, does not contain any deficiencies from the current commercial codes in many European countries (except for commercial customs, cultural and local conditions), it is also possible to say that it brings many practices with it which can be considered reforms.

Not only will the new TCC bring about fundamental changes for companies, it will also bring innovations and changes that will affect the whole business life entirely. In order to understand the purpose and spirit of this Code, it is important to understand the justifications for it, as well as the Code itself. For the first time in years, the justifications are expressed so scientifically and clearly in a Code that includes such radical changes.

The first of the most important two subjects in the Code is that it aims to remove closed-type companies, in other words, family companies, and makes it mandatory to implement corporate governance; the second is to make it mandatory for all companies to act in accordance with the principle of transparency, regulate its sanctions, and make independent auditing mandatory.

The TCC consists of six books: (i) Enterprise Law; (ii) Company Law; (iii) Securities Law; (iv) Maritime Commercial Law; (v) Transportation Law; and (vi) Insurance Law.

The importance of the TCC is the fact that it gives prominence to accounting, auditing, and financial reporting, as well as its legal dimension. For example, when we remove approximately 10 articles about auditing from this Code (consisting of 1,535 articles), it loses all its effect, cannot be implemented, and its written purposes cannot be realized. Therefore, the Code requires companies to make changes first in their accounting practices and then auditing practices.

The Code gives to members of professions the function of business consultant, in addition to the work of auditing. Accordingly, members of the profession shall be able to provide various services to companies in many areas apart from auditing.

New Turkish Commercial Code and Auditing

Three types of auditing are foreseen in the Code: (i) independent auditing; (ii) process auditing; and (iii) private auditing.

Auditors may not provide consultancy or service to the company that they audit, except for tax consultancy and tax auditing; further, they cannot do this through a subsidiary company (Article 400).

The Code makes it mandatory for all companies to be independently audited. Companies shall work with independent auditing institutes and independent auditing institutes shall be able to be audited by a certified public accountants (SMMM) or sworn-in certified public accountants (YMM). Only some companies that cannot exceed certain growths shall be able to have an SMMM or YMM independently audit them. It is prohibited for an SMMM or YMM (or institution) that keeps books, provide consultancy, and have commercial relations with a company to provide independent auditing to that company.

New Turkish Commercial Code and Financial Reporting

The TCC makes it mandatory for all companies to perform their accounting records in accordance with TFRS (or TFRS for SMEs) and also to prepare their financial reports in accordance with TFRS starting from January 1, 2013. According to Article 88:

[N]atural and legal persons must fully comply with and implement Turkish Accounting Standards which were published by Turkish Accounting Standards Board, the accounting principles contained in conceptual framework and the interpretations, which are an inseparable part of them, while keeping their commercial accounts, and preparing their individual and consolidated financial statements ...

With this Code, the following changes, inter alia, are stipulated for accounting practices:

- Legal infrastructures of e-books are created with this Code.
- It is possible to keep accounts in a digital environment.
- Account books are under the responsibility of an administrative board.
- Account books shall be kept in compliance with TFRS.
- Tax shall be calculated from the declaration after market profit.

New Uniform Chart of Accounts (Draft)

Since the TCC requires account books to be kept in compliance with TFRS, the uniform chart of accounts that is used by entities is revised in accordance with TFRS and presented to public opinion before publishing by the TASB.

Implementing TFRS, which is same with IFRS, in account books and developing a chart of accounts suitable for this shall be the first practice in the world.

Article 1 (Purpose)

Turkish Accounting Standards Board (TASB), which was established with Law No. 4487 in order to stop the multi-headed practices about accounting and financial reporting, has adopted International Accounting Standards (IAS), currently named International Financial Reporting Standards (IFRS), and published Turkish Accounting/Financial Reporting Standards within the scope of this duty which was given to it. It also published "Turkish Financial Reporting Standard for SME's" for small and medium scaled entities (SME), which is in compliance with International Financial Reporting Standards. Also published was Accounting System Application General Communiqué no. 1: Financial Statement Formats which determined at what detail and format the financial statements shall be prepared in order to provide a uniform structure and achieve comparability in the practices of Turkey. Within this scope, there emerged a need to update the contents of financial statements as well as the uniform chart of accounts in order to keep accounts of enterprises and entities that belong to natural and legal persons in accordance with Turkish Accounting Standards published by Turkish Accounting Standards Boards (TASB), to make audits in entities easier and to make sure information that is submitted to those concerned are dependable, comprehensible, all-purpose, consistent, comparable and real. This communiqué is for the purpose of explaining the chart of accounts that shall be implemented by entities which are operating outside of finance sector.

Article 5 (Entities that shall implement the chart of accounts)

- (1) According to the laws of Republic of Turkey, entities and institutes which are obliged to keep accounting books in balance sheet basis, yet outside of the scope of Public Finance Management and Control Law, implement Turkish Accounting Standards when keeping their legal account books and preparing their financial statements. However, there are some establishments that are obliged to use different accounting techniques due to their areas of activity even though they must keep accounting books in balance sheet basis in terms of practicing chart of accounts and the content of financial statements. Those are:
 - (a) Banks and insurance companies,
 - (b) Other financial institutes,
 - (c) Financial leasing companies, factoring companies and other companies that operate in similar fields,
 - (d) Other financial sector entities such as mutual funds, intermediary firms and investment trusts.

The companies above implement the chart of accounts which is recommended for their sectors and approved by TASB instead of the general chart of accounts and they prepare their financial statements in a system that is recommended for their sectors.

Entities that keep account books in operating account basis are only obliged to comply with the "Basic Concepts of Accounting," which is determined within conceptual framework of Turkish Accounting Standards.

- (2) Uniform chart of accounts are regulated in a way that meets the requirements of all companies. Entities open up and use accounts that are necessary for their needs, accounts that won't work with their entities at all are not opened.

Article 6 (The relation of the prepared regulation with tax legislation and its sanction)

Financial Position Statement (Balance Sheet), Comprehensive Income Statement, Cash Flow Statement and Statement of Changes in Equity, which were regulated in line with Conceptual Framework, exemption and exceptional practices, are financial statements that were regulated in accordance with accounting standards. Legal accounting books are recorded in accordance with Turkish Accounting Standards. The provisions about the evaluation of economic assets in Tax Procedural Law are about the calculation of tax assessment; and the income or corporate tax for a period is externally calculated from the tax assessment which is found from the accounting (commercial) profit in the financial statements regulated in accordance with these standards, by considering the increasing and decreasing effect of valuation provisions in Tax Procedure Law, and by adding or subtracting the non-allowable charges and tax-free income. The processes concerning the determination of tax assessment is shown in the conversion table where accounting (commercial) profit is turned into financial profit.

Necessary criminal actions shall be taken against those who didn't comply with regulated accounting methods and principles, when they were obliged to, pursuant to related provisions of Tax Procedural Law No. 213 and Law No. 3568 on Certified Public Accountancy and Sworn-in Certified Public Accountancy.

*General Communiqué on Uniform Chart of
Accounts Application (Draft)*

Entities implement TAS/TFRS, Interpretations, Turkish Financial Reporting Standard for SMEs, and the provisions in Communiqué for Accounting Standards Application for the accounting, measuring and evaluation of financial events, and financial reporting. Entities that have to answer to the public implement the full set of TAS/TFRS, while SMEs implement TFRS for SMEs. SMEs may use the full set of TAS/TFRS if they desire. Micro-scaled entities use TFRS for SMEs within the framework of exemptions and exceptions that are granted to them.

It is very important to ensure a uniform practice in the principle of calculations and accounting, which is used in financial statements in order to keep accounts of enterprises and entities that belong to natural and legal persons in accordance with TAS published by the TASB, to make audits in

entities easier and to make sure that information that is submitted to those concerned is dependable, comprehensible, all-purpose, consistent, comparable, and real. The advantages obtained from a uniform chart of accounts application was seen from past implementations. The developments in accounting standards introduced the need to update the chart of accounts. This regulation aims to:

- transmit the accounting information to the concerned people, who are in decision-making position sufficiently and correctly;
- compare the different period of an entity with a different entity;
- have the accounting names located in financial statements to give the same meaning for all segments;
- attain a unity of terms in accounting, thus making it understandable; and
- to build an element of trust between entities and concerned people.

Thus, with this regulation, it is aimed to reach a uniform system in accounting practices of Turkey and have the same entity language for all segments.

Entities are obliged to set up their accounting systems in line with the uniform chart of accounts and framework. The operation of accounts takes place as stated in the chart of account descriptions.

This communiqué is for the purpose of explaining the chart of accounts that shall be implemented by entities which are operating outside of finance sector.

According to laws of the Republic of Turkey, entities and institutes which are obliged to keep accounting books on a balance sheet basis, yet outside of the scope of the Public Finance Management and Control Law, implement TAS when keeping their legal account books and preparing their financial statements. However, there are some establishments that are obliged to use different accounting techniques due to their areas of activity even though they must keep accounting books on a balance sheet basis in terms of practicing the chart of accounts and the content of financial statements. Those are:

- (a) banks and insurance companies;
- (b) other financial institutes;
- (c) financial leasing companies, factoring companies, and other companies that operate in similar fields; and
- (d) other financial sector entities such as mutual funds, intermediary firms, and investment trusts.

The above companies implement the chart of accounts which is recommended for their sectors and approved by TASB instead of the

general chart of accounts, and they prepare their financial statements in a system that is recommended for their sectors.

Entities that keep account books in operating account basis are only obliged to comply with the "Basic Concepts of Accounting," which is determined within the conceptual framework of TAS.

The uniform chart of accounts is regulated in a way that meets the requirements of all companies. Entities open up and use accounts that are necessary for their needs; accounts that will not work with their entities at all are not opened.

This communiqué regulates the following:

- (a) uniform accounting framework;
- (b) chart of accounts; and
- (c) explanations of chart of accounts.

New Financial Statement Formats (Draft)

Financial statements are prepared in accordance with the Conceptual Framework published by TASB, TAS/IFRS, and Interpretations and provisions of IFRS for SMEs. Accounting principles and assumptions explained in the Conceptual Framework are taken as the baseline for creating accounting records and financial statements. The purpose of financial statements is to give information to a wide user group (current and potential investors, lenders, and other creditors) about finance, such as the financial status of the reporting entity, activity result, and cash flow that will be beneficial when making economical decisions.

Financial statements also show the performance of managers, in other words, their accountability for the usage of resources that were entrusted to them. A set of financial statements is composed of statements and explanatory footnotes described in TAS/IFRS or IFRS for SMEs. Accordingly, the following financial statement formats are available:

1. financial position statement (balance sheet);
2. income and comprehensive income statement;
3. cash flow statement;
4. statement of changes in equity;
5. disclosure;
6. consolidated financial statements; and
7. financial statements (equity method in use).

Public Oversight, Accounting and Auditing Standards Agency

In order to comply with eight directives of the European Union, the Public Oversight, Accounting and Auditing Standards Agency (POAASA) was established in Turkey on November 2, 2011, by way of a legal arrangement. The organization of this agency is to be completed within six months. The TASB was abolished and all missions and authority, as well as financial resources of TASB, were transferred to this new agency. Hence, the POAASA was given the authority of the implementation of the new Commercial Code and the making of regulations for independent auditing.

The scope of the authority and responsibilities of the POAASA are:

- accounting standards;
- auditing standards;
- supervision of examination of independent auditing;
- discipline;
- ethics;
- quality assurance; and
- admission of foreign companies to the auditing list.

The purpose of the establishment of the POAASA, as defined in Article 1, is

[T]o develop and publish Turkish accounting standards in compilation with international accounting standards, to provide quality of standards on auditing, to accomplish public oversight in the field of auditing, to authorize independent audit organizations and to control their activities

Other authorized institutions, such as the CMB, the BRSA, and the Energy Market Regulatory Authority will continue their activities until the POAASA completes its establishment. The POAASA board consists of nine members: two each from the Ministry of Customs and Trade, the Ministry of Finance, the Under-Secretariat of Treasury; and one each from the CMB, the BRSA, the Union of Chambers of Certified Public Accountants and Sworn-in Certified Public Accountants, and the Union of Chambers of Commerce.

CONCLUSION

Until today, financial reporting applications were tax oriented and did not take into consideration the needs of the financial sector and publicly traded

companies. Now, companies are preparing their financial statements in conformity with IFRS (TFRS). This transition is accelerated by the increase in foreign investments and business combinations and the enforcement of new TCC. TÜRMOB, which is the top-level organization of the accounting profession, has begun to educate accounting professionals on IFRS and IFRS for SMEs. Although the accounting profession in Turkey does not have a long-standing background, Turkish accountants are constantly renewing themselves in line with global developments. With the new TCC, the accounting profession began to divide into specialized areas, such as independent audit, forensic accounting, managerial accounting, and internal audit. In addition to these, tax accounting maintains its importance because some sectors and SMEs are supported by the government in terms of tax incentives and exemptions. Structural reforms aim at the economic and social development of the Turkish Republic, which will celebrate its 100th anniversary. The plans made in light of these arrangements show that there will be a significant number of global companies in the country and that these companies will contribute to the economic development, provided that the financial reporting and independent auditing work properly.

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